

No. 14732

United States
Court of Appeals
for the Ninth Circuit

PACIFIC HOMES, INC., a Corporation,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

Transcript of Record

Appeal from the United States District Court for the
Northern District of California,
Southern Division

FILED

SEP - 9 1955

PAUL P. O'BRIEN, CLERK

Phillips & Van Orden Co., 870 Brannan Street, San Francisco, Calif.—7-23-55

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INDEX

[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

	PAGE
Answer	17
Certificate of Clerk to Record on Appeal.....	165
Complaint	3
Exhibits, Defendant's:	
A—Corporation Income and Declared Value Excess Profits Tax Return, Form 1120, for Year Ending May 31, 1942	104
B—Corporation Income and Declared Value Excess Profits Tax Return, Form 1120, for Year Ending May 31, 1943	106
C—Corporation Income and Declared Value Excess Profits Tax Return, Form 1120, for the Year Ending May 31, 1944	108
D—Extract From Minutes of Special Meet- ing of the Directors of Pacific Homes, Inc., Held on December 9, 1943.....	154
Exhibits, Plaintiff's:	
No. 8—Folder Containing Papers Re Southwood Tract	62

INDEX

PAGE

Exhibits, Plaintiff's—(Continued)

9—Folder Containing Papers Re Shoreview Tract	67
10—Folder Containing Papers Re Homewood Tract	71
11—Data Re Number and Types of Leases	75
12—Form PD-105, Homewood Tract, December 31, 1941.....	156
13—Form PD-105, Homewood Tract, April 6, 1942.....	157
14—Form PD-105, Shoreview Tract, May 28, September 9 and October 21, 1943	158
15—Form PD-105, Shoreview Tract, May 28, September 9 and October 21, 1943	158
16—Form PD-105, Shoreview Tract, May 28, September 9 and October 21, 1943	158
17—Form PD-105, Southwood Tract, September 9, 1943.....	159
18—Form 1120-US, Corporation Tax Return, 1945	161
19—Form 1120-US, Corporation Tax Return, 1946	162
20—Form 1120-US, Corporation Tax Return, 1947	163

INDEX

PAGE

Exhibits, Plaintiff's—(Continued)	
21—Form 1121, Corporation Excess Profits Tax Return, 1946.....	164
22—Instructions for Form 1120, 1946..	95
Findings of Fact and Conclusions of Law.....	43
Judgment	49
Memorandum Opinion	39
Names and Addresses of Attorneys.....	1
Notice of Appeal.....	50
Statement of Points Upon Which Plaintiff-Appellant, Intends to Rely.....	167
Stipulation, Filed December 13, 1954.....	23
Ex. No. 1—Letter to Mr. McGinness.....	30
2—Rents Received, June 1, 1942, to April 30, 1947.....	33
3—Profit From Real Property Sales, June 1, 1942, to April 30, 1947	34
4—Investment in Real Property, Notes and Mortgages Payable at Close of Each Fiscal Year From May 31, 1942, to May 31, 1946	35
5—Summary Showing Sales of Houses Which Were Originally Occupied by Tenants Under Leases With 30-Month Options to Purchase	36

	INDEX	PAGE
6—Summary Showing Sales of Houses at Southwood Tract, None of Which Were Ever Occupied by Tenants Under Leases With Options to Purchase	37	
7—Summary Showing Sales of Houses at Shoreview Tract, None of Which Were Ever Occupied by Tenants Under Leases With Options to Purchase	38	
Stipulation That Portions of Exhibits Need Not Be Printed	174	
Transcript of Proceedings.....	51	
Opening Statement on Behalf of the Government	58	
Opening Statement on Behalf of the Plaintiff	52	
Witnesses, Plaintiff's:		
Chamberlain, Ross H.		
—direct	117	
—cross	137	
Mabey, Charles P.		
—direct	83	
—cross	98	
Moore, James E.		
—direct	60, 146	
—cross	78	

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In the Southern Division of the United States
District Court, Northern District of California

No. 31368

PACIFIC HOMES, INC., a California Corpora-
tion,

Plaintiff,

vs.

UNITED STATES OF AMERICA,

Defendant.

COMPLAINT TO RECOVER TAXES PAID

Plaintiff respectfully alleges as follows:

First Claim for Relief

I.

Plaintiff is a corporation duly organized and existing under and by virtue of the Laws of the State of California and is a resident of the Southern Division of the Northern Judicial District of California. Plaintiff was dissolved in the calendar year 1947, and on or about April 30, 1947, distributed all of its then known assets to its sole stockholder. Plaintiff prosecutes this action by reason of the authority contained in rule 17(b) of the Federal Rules of Civil Procedure, and by reason of the provisions of sections 5400, 5401 and 5402 of the California Corporations Code, which said last mentioned sections provide in substance and effect that a corporation which is dissolved nevertheless continues to exist for the purpose of winding up its affairs, prosecuting

and defending actions by or against, it, and enabling it to collect and discharge obligations and collect and divide its assets, and that any assets inadvertently or otherwise omitted from the winding up continue in the dissolved corporation for the benefit of the persons entitled thereto upon dissolution of the corporation.

II.

James G. Smyth was the duly appointed, qualified and acting Collector of Internal Revenue for the First District of California at all times during the period from May 14, 1945, to and including September 27, 1951. Said James G. Smyth is not now in office as Collector of Internal Revenue. All amounts of United States Internal Revenue Taxes for the recovery of which suit is filed herewith were erroneously or illegally collected from plaintiff by defendant through said James G. Smyth as such Collector of Internal Revenue. All corporation tax returns hereinafter alleged to have been filed with defendant were filed with defendant through said James G. Smyth as such Collector of Internal Revenue.

III.

This is a cause of actual controversy of a civil nature arising under a law of the United States providing for internal revenue, to wit, the "Internal Revenue Code," enacted on February 10, 1939, as Public No. 1, 76th Congress, 1st sess. C. 2, 53 Stat. 1, as amended (Title 26, U.S.C.A., sections 1, et seq., as amended).

IV.

Jurisdiction is conferred by Title 28, U.S.C.A., sections 1340 and 1346.

V.

Plaintiff was incorporated under the laws of the State of California on August 9, 1941, and thereafter duly adopted a fiscal year ending on the 31st day of May of each year for the purpose of closing its accounts and filing its tax returns. Plaintiff at all times herein mentioned maintained and closed its books on the accrual method of accounting and at all times herein mentioned plaintiff filed its Federal Corporation Income and Federal Corporation Excess Profits Tax returns on the accrual basis.

VI.

During the fiscal year ended May 31, 1946, plaintiff sold certain personal property and also certain real property consisting of land and houses which had been previously constructed by plaintiff and held by plaintiff for rental and investment purposes. All of said land, houses and personal property sold by plaintiff as herein in this paragraph VI alleged, had been held by plaintiff for rental and investment purposes more than six months preceding the respective sales of said property. Plaintiff realized from the sales of said real and personal property so held for more than six months, a gain of \$327,268.85.

VII.

In addition to the real and personal property sold by plaintiff, as more particularly described in para-

graph VI hereof, plaintiff, during the fiscal year ended May 31, 1946, also sold 39 parcels of improved real property, none of which had been held by plaintiff for six months preceding their respective sales. Plaintiff sustained a loss of \$9,561.66 from the sale of said 39 parcels.

VIII.

The sum of \$317,707.19, representing the excess of the gain on the sales of the property described in paragraph VI hereof, over the loss on the sales of the improved real property described in paragraph VII hereof, constitutes a long-term capital gain which is not subject to United States Excess Profits Tax for the fiscal year ended May 31, 1946, by reason of the provisions contained in section 711 of the Internal Revenue Code. Said gain of \$317,707.19 constitutes gain from the sale of "Capital Assets," as provided by section 117 of the Internal Revenue Code.

IX.

Plaintiff duly and regularly, and in the manner and within the time provided by law, filed its federal income and federal excess profits tax returns with defendant for the fiscal year ended May 31, 1946, and reported therein as net long-term capital gains the net gains reported on the sales of the real and personal property referred to in paragraphs VI and VII hereof. Plaintiff paid to defendant all of the federal corporation income and excess profits taxes shown to be due on its said returns so filed, as aforesaid, for the fiscal year ended May 31, 1946. Thereafter, a deficiency of \$111,151.11 was determined,

with respect to federal corporation excess profits taxes, due from the plaintiff for the fiscal year ended May 31, 1946, and said sum of \$111,151.11, together with interest thereon at 6% per annum from August 15, 1946, was paid to defendant on or about February 3, 1948. Said deficiency of \$111,151.11 and interest thereon, was determined by including as subject to United States Federal Excess Profits tax for the fiscal year ended May 31, 1946, the net gain of \$317,707.19 more particularly described in paragraph VIII hereof.

X.

Within two years from the date of the payment of said sum of \$111,151.11 and interest thereon, to wit, on or about the 8th day of September, 1949, plaintiff duly and regularly, and in the manner provided by law, filed with defendant in writing, on Treasury Department Form 843, "Claim" a claim for refund of said sum of \$111,151.11, or such greater or lesser amount as might be found legally refundable. Said claim alleged that said net gain of \$317,707.19 described in paragraph VIII hereof, represented the excess of the plaintiff's long-term capital gain over the plaintiff's short-term capital loss and, that accordingly, plaintiff had no Excess Profits Tax liability for the fiscal year ended May 31, 1946.

XI.

On or about the 21st day of March, 1950, said claim so filed by plaintiff, as alleged in paragraph X hereof, was disallowed in full by the Commissioner of Internal Revenue, and said Commissioner,

on or about the 21st day of March, 1950, gave notice in writing to plaintiff, by registered mail, of the said disallowance of plaintiff's claim.

Wherefore, plaintiff prays judgment against defendant as hereinafter set forth.

Second Claim for Relief

I.

Plaintiff hereby refers to and by such reference makes a part hereof, as though fully set forth herein at length, all of the allegations contained in paragraphs I, II, III, IV and V of plaintiff's First Claim for Relief set forth herein.

II.

During the fiscal year ended May 31, 1947, plaintiff sold certain real property consisting of land and houses which had been previously constructed by plaintiff and held by plaintiff for rental and investment purposes. All of said real property sold by plaintiff, as herein in this paragraph II alleged, had been held by plaintiff for rental and investment purposes for more than six months preceding the respective sales of said property. Plaintiff realized from the sales of said real property so held for more than six months a gain of \$66,808.36.

III.

Said sum of \$66,808.36 representing the gain on the sales of said real property described in paragraph II hereof, constitutes a long-term capital gain

and not ordinary income, for the fiscal year ended May 31, 1947, as provided by section 117 of the Internal Revenue Code.

IV.

Plaintiff duly and regularly, and in the manner and within the time provided by law, filed its Federal Income Tax Return with defendant for the fiscal year ended May 31, 1947, and reported therein as capital gains the gains reported on the sales of the real property referred to in paragraph II hereof. Plaintiff paid to defendant all of the Federal Corporation Income Taxes shown to be due on its said return so filed for the fiscal year ended May 31, 1947. Thereafter, a deficiency in the amount of \$7,083.47 was determined with respect to federal corporation income taxes due from plaintiff, and said sum of \$7,083.47, together with interest thereon at 6% per annum from August 15, 1947, was paid to defendant on or about February 3, 1948. Said deficiency of \$7,083.47 and interest thereon, was determined by including as subject to United States Federal Income Tax at ordinary rates and not at capital gain rates, the gain of \$66,808.36, more particularly described in paragraph III hereof.

V.

Within two years from the date of the payment of said sum of \$7,083.47 and interest thereon, to wit, on or about the 8th day of September, 1949, plaintiff duly and regularly, and in the manner provided by law, filed with defendant in writing, on Treasury Department Form 843, "Claim," a claim for refund

of said sum of \$7,083.47, or such greater or lesser amount as might be found legally refundable. Said claim alleged that said gain of \$66,808.36 was properly reported by plaintiff on its Federal Corporation Income Tax Return as long-term capital gain and that said sum was not taxable as ordinary income.

VI.

As a result of deficiencies alleged to be due from plaintiff for additional federal income and excess profits taxes for fiscal years ended prior to May 31, 1947, plaintiff paid interest on or about February 3, 1948, to defendant in the amount of \$6,618.55, said interest being applicable to fiscal years ended May 31, 1945, and May 31, 1946. Said sum of \$6,618.55 represents an interest accrual to and including April 30, 1947, and is an allowable deduction in the computation of plaintiff's federal income and excess profits tax liability for the fiscal year ended May 31, 1947. The amount of refund of federal income and excess profits taxes due to plaintiff applicable to said interest payment of \$6,618.55 is the sum of \$2,515.04, all as more particularly alleged and set forth in Treasury Department Form 843, Claim, heretofore filed by plaintiff, as alleged in paragraph V hereof.

VII.

On or about the 21st day of March, 1950, said claim so filed by plaintiff, as alleged in paragraph V hereof, was disallowed in full by the Commissioner of Internal Revenue, and said Commissioner, on or about the 21st day of March, 1950, gave notice in

writing to plaintiff, by registered mail, of the said disallowance of plaintiff's claim.

Wherefore, plaintiff prays judgment against defendant as hereinafter set forth.

Third Claim for Relief

I.

Plaintiff hereby refers to and by such reference makes a part hereof, as though fully set forth herein at length, all of the allegations contained in paragraphs I, II, III, IV, and V of plaintiff's First Claim for Relief set forth herein.

II.

During the fiscal year ended May 31, 1945, plaintiff sold certain real property consisting of land and houses which had been previously constructed by plaintiff and held by plaintiff for rental and investment purposes. All of said land and houses sold by plaintiff, as herein in this paragraph II alleged, had been held by plaintiff for rental and investment purposes for more than six months preceding the respective sales of said property. Plaintiff realized from the sales of said real property so held for more than six months, a gain of \$76,040.80, of which amount \$7,272.83 represented unrealized profits on installment sales which were deferred to future years, leaving a net gain applicable to the fiscal year ended May 31, 1945, of \$68,767.97. In addition to said net gain of \$68,767.97, plaintiff during the fiscal year ended May 31, 1945, sold an unimproved parcel of real property which had been held by

plaintiff for investment for more than six months at the time of its sale, and plaintiff realized from said sale a gain of \$424.21.

III.

The sum of \$69,192.18, representing the aggregate gain from the sale of improved and unimproved real property, more particularly described in paragraph II hereof, constitutes long-term capital gain which is not subject to United States excess profits tax for the fiscal year ended May 31, 1945, by reason of the provisions contained in section 711 of the Internal Revenue Code. Said gain of \$69,192.18 constitutes gain from the sale of "capital assets," as provided by section 117 of the Internal Revenue Code.

IV.

Plaintiff duly and regularly, and in the manner and within the time provided by law, filed its federal income and federal excess profits tax returns with defendant for the fiscal year ended May 31, 1945, and reported therein, as long-term capital gains, the sum of \$69,192.18, representing net gains reported on sales of said real property described in paragraphs II and III hereof. Plaintiff paid to defendant all of the federal income and excess profits taxes shown to be due on its said returns so filed as aforesaid, for the fiscal year ended May 31, 1945. Thereafter, a deficiency of \$18,741.37 was determined with respect to federal corporation excess profits taxes due from plaintiff for the fiscal year ended May 31, 1945, and said sum of \$18,741.37, together with interest thereon at 6% per annum from August 15,

1945, was paid to defendant on or about February 3, 1948. Said deficiency of \$18,741.37 and interest thereon was determined by including, as subject to United States federal excess profits tax, the gain of \$69,192.18 more particularly described in paragraphs II and III hereof.

V.

Within two years from the date of the payment of said sum of \$18,741.37 and interest thereon, to wit, on or about the 8th day of September, 1949, plaintiff duly and regularly, and in the manner provided by law, filed with defendant in writing, on Treasury Department Form 843, Claim, a claim for refund of said sum of \$18,741.37, or such greater or lesser amount as might be found legally refundable. Said claim alleged that said gain of \$69,192.18 represented a long-term capital gain and that, accordingly, plaintiff had no excess profits tax liability for the fiscal year ended May 31, 1945.

VI.

On or about the 6th day of February, 1951, said Claim so filed by plaintiff, as alleged in paragraph V hereof, was disallowed in full by the Commissioner of Internal Revenue, and said Commissioner, on or about the 6th day of February, 1951, gave notice in writing to plaintiff, by registered mail, of the said disallowance of plaintiff's claim.

Wherefore, plaintiff prays judgment against defendant as hereinafter set forth.

Fourth Claim for Relief

I.

Plaintiff hereby refers to and by such reference makes a part hereof, as though fully set forth herein at length, all of the allegations contained in paragraphs I, II, III, IV and V of plaintiff's First Claim for Relief set forth herein.

II.

During the fiscal year ended May 31, 1945, plaintiff sold certain real property consisting of land and houses which had been previously constructed by plaintiff and held by plaintiff for rental and investment purposes. All of said land and houses sold by plaintiff, as herein in this paragraph II alleged, had been held by plaintiff for rental and investment purposes for more than six months preceding the respective sales of said property. Plaintiff realized from the sales of said real property so held for more than six months a gain of \$76,040.80, of which amount \$7,272.83 represented unrealized profits on installment sales which were deferred to future years, leaving a net gain applicable to the fiscal year ended May 31, 1945, of \$68,767.97. In addition to said net gain of \$68,767.97, plaintiff, during the fiscal year ended May 31, 1945, sold an unimproved parcel of real property which had been held by plaintiff for investment for more than six months at the time of its sale, and plaintiff realized from said sale a gain of \$424.21.

III.

The sum of \$69,192.18, representing the aggregate gain from the sale of improved and unimproved real property more particularly described in paragraph II hereof, constitutes long-term capital gain and does not constitute ordinary income subject to tax as provided in the United States Internal Revenue Code. Said gain of \$69,192.18 constitutes gain from the sale of "capital assets" as provided in section 117 of the Internal Revenue Code.

IV.

Plaintiff duly and regularly, and in the manner and within the time provided by law, filed its federal income and federal excess profits tax returns with defendant for the fiscal year ended May 31, 1945, and reported therein as long-term capital gains the sum of \$69,192.18, representing net gains reported on the sales of real property referred to in paragraphs II and III hereof. Plaintiff paid to defendant all of the federal corporation income and excess profits taxes shown to be due on said returns so filed as aforesaid, for the fiscal year ended May 31, 1945. Thereafter, a deficiency of \$4,065.53 was determined with respect to the federal corporation income tax due from plaintiff for the fiscal year ended May 31, 1945, and said sum of \$4,065.53, together with interest thereon at 6% per annum from August 15, 1945, was paid to defendant on or about February 3, 1948. Said deficiency of \$4,065.53 and interest thereon was determined by including as subject to United States corporation income tax at ordinary

rates and not as long-term capital gain, the said gain of \$69,192.18, more particularly described in paragraph III hereof.

V.

Within two years from the date of the payment of said sum of \$4,065.53 and interest thereon, to wit, on or about the 8th day of September, 1949, plaintiff duly and regularly and in the manner provided by law, filed with defendant, in writing, on Treasury Department Form 843, Claim, a claim for refund of said sum of \$4,065.53, or such greater or lesser amount as might be found legally refundable. Said claim alleged that said gain of \$69,192.18 represented long-term capital gain taxable as provided in section 117 of the United States Internal Revenue Code and not taxable as ordinary income.

VI.

On or about the 15th day of May, 1950, said claim so filed by plaintiff, as alleged in paragraph V hereof, was disallowed in full by the Commissioner of Internal Revenue, and said Commissioner, on or about the 15th day of May, 1950, gave notice in writing to plaintiff, by registered mail, of the said disallowance of plaintiff's claim.

Wherefore, plaintiff prays judgment against defendant as follows:

1. For the sum of \$111,151.11, together with interest thereon at 6% per annum from August 15, 1946; and
2. For the sum of \$7,083.47, together with in-

terest thereon at 6% per annum from August 15, 1947; and

3. For the sum of \$18,741.37; together with interest thereon at 6% per annum from August 15, 1945; and

4. For the sum of \$4,065.53, together with interest thereon at 6% per annum from August 15, 1945; and

5. For plaintiff's costs incurred herein; and

6. For such other and further relief as to this Court may seem proper in the premises.

/s/ L. W. WRIXON,
Attorney for Plaintiff.

[Endorsed]: Filed March 19, 1952.

[Title of District Court and Cause.]

ANSWER

Comes Now the United States of America, defendant herein, by and through Chauncey Tramutolo, United States Attorney in and for the Northern District of California, and for its answer to the complaint filed in the above-entitled action, alleges and says as follows:

First Claim for Relief

1. Defendant admits the allegations contained in paragraph I of plaintiff's first claim for relief.

2. Defendant denies that any United States internal revenue taxes, for the recovery of which the above-entitled action is filed, were erroneously or illegally collected. Defendant admits the remaining allegations contained in paragraph II of the plaintiff's first claim for relief.

3. Defendant admits the allegations contained in paragraph III of plaintiff's first claim for relief.

4. Defendant admits the allegations contained in paragraph IV of plaintiff's first claim for relief.

5. Defendant admits the allegations contained in paragraph V of the plaintiff's first claim for relief.

6. Defendant denies the allegations contained in paragraph VI of plaintiff's first claim for relief, except that it admits the following:

(a) That during the fiscal year ended May 31, 1946, plaintiff sold certain personal property and also certain real property consisting of land and houses.

(b) That plaintiff realized from the sales of the said real and personal property a gain of \$327,268.85.

7. Defendant admits the allegations contained in paragraph VII of plaintiff's first claim for relief.

8. Defendant denies the allegations contained in paragraph VIII of the plaintiff's first claim for relief.

9. Defendant admits the allegations contained in

paragraph IX of plaintiff's first claim for relief except that it denies that the deficiency and interest there described were paid on February 3, 1948. Defendant alleges that payments aggregating the sum alleged and interest were made on February 4, April 21 (by credit application), May 19 and September 13, 1948.

10. Defendant admits the allegations contained in paragraph X of plaintiff's first claim for relief.

11. Defendant admits the allegations contained in paragraph XI of the plaintiff's first claim for relief.

Second Claim for Relief

12. Defendant's answer to paragraph I of plaintiff's second claim for relief is the same as that previously set forth in response to the allegations contained in paragraphs I, II, III, IV and V of plaintiff's first claim for relief.

13. Defendant denies the allegations contained in paragraph II of plaintiff's second claim for relief, except that it admits the following:

(a) That during the fiscal year ended May 31, 1947, plaintiff sold certain real property consisting of land and houses.

(b) That plaintiff realized from the sale of said real property a gain of \$66,808.36.

14. Defendant denies the allegations contained in paragraph III of plaintiff's second claim for relief.

15. Defendant admits the allegations contained in paragraph IV of plaintiff's second claim for relief except that it denies that the deficiency and interest there described were paid on February 3, 1948. Defendant alleges that payments aggregating the sum alleged and interest were made on February 4, 1948, and April 21, 1948 (by credit application).

16. Defendant admits the allegations contained in paragraph V of plaintiff's second claim for relief.

17. Defendant denies the allegations contained in paragraph VI of plaintiff's second claim for relief.

18. Defendant admits the allegations contained in paragraph VII of plaintiff's second claim for relief.

Third Claim for Relief

19. Defendant's answer to paragraph I of plaintiff's third claim for relief is the same as that previously set forth in response to the allegations contained in paragraphs I, II, III, IV and V of plaintiff's first claim for relief.

20. Defendant denies the allegations contained in paragraph II of plaintiff's third claim for relief, except that it admits the following:

(a) That during the fiscal year ended May 31, 1945, plaintiff sold certain real property consisting of land and houses.

(b) That plaintiff realized from the sale of said real property a net gain of \$68,767.97, applicable to the fiscal year ended May 31, 1945.

(c) That during the fiscal year ended May 31, 1945, plaintiff sold an unimproved parcel of real property.

(d) That plaintiff realized from the sale of said unimproved parcel of real property a gain of \$424.21.

21. Defendant denies the allegations contained in paragraph III of plaintiff's third claim for relief.

22. Defendant admits the allegations contained in paragraph IV of plaintiff's third claim for relief except that it denies that the deficiency and interest there described were paid on February 3, 1948. Defendant alleges that payments aggregating the sum alleged and interest were made on February 4, 1948, and on April 21, 1948 (by credit application).

23. Defendant admits the allegations contained in paragraph V of plaintiff's third claim for relief.

24. Defendant admits the allegations contained in paragraph VI of plaintiff's third claim for relief.

Fourth Claim for Relief

25. Defendant's answer to paragraph I of plaintiff's fourth claim for relief is the same as that previously set forth in response to the allegations contained in paragraphs I, II, III, IV and V of plaintiff's first claim for relief.

26. Defendant denies the allegations contained in paragraph II of the plaintiff's fourth claim for relief except that it admits the following:

- (a) That during the fiscal year ended May 31, 1945, plaintiff sold certain real property consisting of land and houses.
- (b) That plaintiff realized from the sale of said real property a net gain of \$68,767.97, applicable to the fiscal year ended May 31, 1945.
- (c) That during the fiscal year ended May 31, 1945, plaintiff sold an unimproved parcel of real property.
- (d) That plaintiff realized from the sale of said unimproved parcel of real property a gain of \$424.21.

27. Defendant denies the allegations contained in paragraph III of plaintiff's fourth claim for relief.

28. Defendant admits the allegations contained in paragraph IV of plaintiff's fourth claim for relief, except that it denies that the deficiency determined with respect to the Federal corporation income tax due from plaintiff for the fiscal year ended May 31, 1945, was \$4,065.53, and alleges said deficiency was \$3,622.99; and defendant denies that plaintiff paid the sum of \$4,065.53 on February 3, 1948, with interest, but alleges that it paid the aggregate sum of \$3,622.99, with interest thereon, on the dates of February 4, 1948, and on April 21, 1948 (by credit application).

29. Defendant admits the allegations contained in paragraph V of plaintiff's fourth claim for relief, except that it denies that plaintiff paid the sum of \$4,065.53, with interest thereon, as a deficiency in corporation income taxes for the fiscal year ended May 31, 1945, but alleges that the amount of said deficiency paid by plaintiff was \$3,622.99.

30. Defendant admits the allegations contained in paragraph VI of plaintiff's fourth claim for relief.

Wherefore, defendant demands judgment against plaintiff and costs.

/s/ CHAUNCEY TRAMUTOLO,
United States Attorney.

[Endorsed]: Filed October 15, 1952.

[Title of District Court and Cause.]

STIPULATION

The parties to this action, through their respective counsel, hereby stipulate that the following facts are true:

1. Pacific Homes, Inc., the plaintiff herein (hereinafter sometimes referred to as "Pacific"), is a dissolved corporation. Pacific was incorporated under the laws of the State of California on August 9, 1941, under the name of "Emergency Houses Corporation." The corporate name was, on December 22, 1941, changed to "Pacific Coast Homes, Inc."

and on January 30, 1942, the corporate name was changed to "Pacific Homes, Inc."

2. On November 12, 1946, a "Certificate of Election of Pacific Homes, Inc., to Wind Up and Dissolve" was filed with the Secretary of State of the State of California. On May 31, 1947, a "Certificate of Dissolution of Pacific Homes, Inc., a California corporation," was filed with the Secretary of State of the State of California.

3. The only shares of stock issued by Pacific were 50 shares of common stock issued for cash, at \$100.00 per share, on February 5, 1942—26 shares to David D. Bohannon and 24 shares to R. H. Chamberlain.

4. On January 4, 1945, the Board of Directors of Pacific authorized the purchase from David D. Bohannon of his 26 shares for \$16,647.00. The purchase of said 26 shares was consummated on May 10, 1945. Ross H. Chamberlain owned said 24 shares of Pacific from date of issuance on February 5, 1942, until the corporation was finally and formally dissolved, as set forth in paragraphs 1 and 2 hereof.

5. Mr. Ross H. Chamberlain was one of the three incorporators of Pacific. Mr. David D. Bohannon was a Director and President of Pacific continuously from January 30, 1942, until January 4, 1945. Mr. Ross H. Chamberlain was a Director and Secretary-Treasurer of Pacific continuously from January 30, 1942, until January 4, 1945. Mr. Ross H. Chamberlain was a Director and President of Pacific continuously from January 4, 1945, until Pacific was

finally and formally dissolved, as set forth in paragraphs 1 and 2 hereof.

6. Pacific filed the following listed six applications for priorities on Form PD105. Each of said applications was for a preference rating to obtain materials which were required to construct single family defense housing dwellings. Each of said applications was granted. Said applications may be summarized by tracts as follows:

Name of Tract	No. of Houses
Homewood	206
Dec. 31, 1941	175 houses
April 6, 1942	31 houses
Southwood	
July 13, 1943	72
Shoreview	
May 29, 1943	51 houses
July 7, 1943	9 houses
Oct. 26, 1943	3 houses

With the exception of application dated December 31, 1941, relating to 175 houses in the Homewood Tract, all of said applications stated that the houses were to be built to rent. Said application dated December 31, 1941, stated the houses were to be built for sale. Shortly before March 8, 1943, Pacific ad-

*Although the priority applications filed with respect to the Homewood Tract covered only 206 houses, 212 houses were in fact built in the Homewood Tract.

dressed a letter to the Federal Housing Administration relating to said December 31, 1941, application concerning 175 houses, said letter reading in part as follows:

“All of the above houses are completed and occupied on the rental option plan. Although the original application was for the purpose of sale, we proceeded on the rental option basis and have given all occupants option to purchase.”

(A copy of said letter is attached, marked Exhibit 1.)

Plaintiff agrees to have available at the trial, the original of each of said applications bearing the approval of the appropriate Government agencies. No objection will be made by either party to an offer of same into evidence by a party thereto.

7. Attached hereto and marked Exhibits No. 2, 3 and 4, are the following listed statements which summarize Pacific's financial and operating results relating to the ownership, rental and sale of houses for the period from its organization to April 30, 1947, the date as of which its then remaining assets were transferred to Ross H. Chamberlain, its sole shareholder. Said exhibits 2, 3 and 4 may be summarized as follows:

Statement	Exhibit No.
(a) Rents received, June 1, 1942, to April 30, 1947	2
(b) Profit from Real Property Sales, June 1, 1942, to April 30, 1947.....	3

- (c) Investment in Real Property and notes and mortgages secured thereby, payable as of the close of each fiscal year from May 31, 1942, to May 31, 1946, inclusive 4
8. Exhibits 5, 6 and 7 attached hereto are correct statements of the facts therein set forth concerning the acquisition, rental and sale by Pacific of Houses at its Homewood, Southwood and Shoreview Tracts.
9. The original or a copy of each of the following listed tax returns filed on behalf of Pacific, namely, Form 1120, United States Corporation Income and Declared Value Excess Profits Tax Returns, and Form 1121, United States Corporation Excess Profits Tax Returns, will be made available by defendant at the trial, and no objection will be made by either party to an offer of same into evidence by a party hereto:
- (a) Form 1120 for fiscal year ended May 31, 1947;
 - (b) Forms 1120 and 1121 for fiscal year ended May 31, 1946;
 - (c) Forms 1120 and 1121 for fiscal year ended May 31, 1945.

10. The parties agree that a copy of the Report of Revenue Agent E. Brenton, dated December 1, 1947, relating to the examination of the Federal Tax Returns listed in paragraph 9 hereof will be made available at the trial, and no objection will

be made by either party to an offer of same into evidence by a party hereto.

11. The houses built in the Homewood, Southwood and Shoreview Tracts referred to in paragraph 6 hereof, were constructed in areas which were designated as critical war effort areas in which there existed a manpower shortage and inadequate housing.

12. None of the houses in the Southwood and Shoreview Tracts was leased with an option in the tenant to purchase the property. Houses in the Homewood Tract were initially leased under terms which granted the tenants a 30-month option to purchase the property.

13. The houses authorized to be constructed pursuant to the priority applications referred to in paragraph 6 hereof were constructed under a Federal Housing Administration Title VI Loan made by various banks to Pacific. A separate loan was made by the lending institution on each house, and a separate promissory note and deed of trust were executed by Pacific for each such loan. As a condition to the granting of such loans, Ross H. Chamberlain and David D. Bohannon were required to and did individually and personally guarantee each loan made by the lending institution on each individual house until such house was completed and the loan became fully insured by the Federal Housing Administration.

14. During the three fiscal years which are involved in this suit, to wit, the fiscal years ended May

31, 1945; May 31, 1946, and May 31, 1947, Pacific sold the houses set forth in Exhibits 5, 6 and 7 attached hereto. Each of the said houses sold during said three fiscal years was held by Pacific for a period of more than six months prior to the date of sale. Seven houses in the Shoreview Tract shown on Exhibit 7 were sold during a prior fiscal year, to wit, the fiscal year ended May 31, 1944, without being held by Pacific for a period of six months prior to the dates of sale.

15. In the event the Court orders judgment be rendered for plaintiff that the gain realized from the sale of some or all of the houses held by Pacific for more than six months be taxed as long-term capital gain, instead of as ordinary income, and the parties hereto are unable to agree upon the principal amount of the judgment and/or the amount of interest to be added thereto, each of the parties, subject to such order as the court may prescribe, shall have the right to offer such additional evidence as may be pertinent to a determination of the amount of such judgment and any interest thereon.

Dated: December 13th, 1954.

/s/ L. W. WRIXON,

/s/ CARL R. SCHULZ,

Attorneys for Plaintiff.

LLOYD H. BURKE,

United States Attorney;

By /s/ GEORGE A. BLACKSTONE,

Assistant United States Attorney, Attorneys for Defendant.

EXHIBIT No. 1

Mr. D. C. McGinness, District Director,
Federal Housing Administration,
315 Montgomery Street,
San Francisco, California.

Re: Priorities Case No. 77-121-000866-Serial
No. 1731.

Dear Mr. McGinness:

No. Units: 175.

No. Rooms: 5 (2 Bedrooms).

Total Payment Per Mo. During Option Period:
\$45.00.

Agreed Sales Price: (24) \$4,100, (151) \$4,000.

Length Option. 30 Mos.

The above application was filed under date of December 31, 1941.

All of the above houses are completed and occupied on the rental option plan. Although the original application was for the purpose of sale, we proceeded on the rental option basis and have given all occupants option to purchase. We now discover in our original application a sales price was set at \$3,675. This obviously was an error as we did not vary from our original estimates of cost and sales price. The price set forth in the option given

to tenants is \$4,100 for 24 of the units and \$4,000 for the balance of 151 units. The F.H.A. commitment on the 24 units is \$3,700 and on the 151 units \$3,600. The total monthly payment on all of the units is \$4,500 per month each.

We will appreciate the approval of the sales price as originally intended as above set forth.

Very truly yours,

PACIFIC HOMES, INC.,

D. D. BOHANNON,
President.

DDB:RW

EXHIBIT No. 2

Pacific Homes, Inc.

Rents Received

(Organization to liquidation of the company)

	Total	June 1/42 to May 31/43	June 1/43 to May 31/44	June 1/44 to May 31/45	June 1/45 to May 31/46	June 1/46 to Apr. 30/47
Homewood Tract:						
Gross rentals	\$ 315,791.86	\$ 83,480.81	\$ 109,011.97	\$ 94,085.78	\$ 28,585.50	\$ 627.80
Expenses	250,501.18	69,243.58	81,832.58	75,184.89	23,736.77	503.36
Net rental income..	\$ 65,290.68	\$ 14,237.23	\$ 27,179.39	\$ 18,900.89	\$ 4,848.73	\$ 124.44
Southwood Tract :						
Gross rentals	\$ 81,272.05		\$ 11,961.32	\$ 42,945.16	\$ 26,430.60	\$ (65.03)
Expenses	67,995.25		9,716.85	34,516.12	23,551.86	210.42
Net rental income..	\$ 13,276.80		\$ 2,244.47	\$ 8,429.04	\$ 2,878.74	\$ (275.45)
Shoreview Tract:						
Gross rentals	\$ 65,811.12		\$ 14,590.08	\$ 32,645.63	\$ 18,460.41	\$ 115.00
Expenses	55,968.48		13,484.55	26,600.82	15,767.23	115.88
Net rental income..	\$ 9,842.64		\$ 1,105.53	\$ 6,044.81	\$ 2,693.18	\$ (.88)
Westwood Tract:*						
Gross rentals	\$ 2,631.04				\$ 900.00	\$ 1,731.04
Expenses	4,027.07				1,201.82	2,825.25
Net rental income (loss)	\$ (1,396.03)				\$ (301.82)	\$ (1,094.21)
Bayshore Park Tract:*						
Gross rentals						
Expenses	\$ 43.28				\$ 10.82	\$ 32.46
Net rental income (loss)	\$ (43.28)				\$ (10.82)	\$ (32.46)
Morey Tract :						
Gross rentals	\$ 3,100.00				\$ 3,100.00	
Expenses	271.73				271.73	
Net rental income..	\$ 2,828.27				\$ 2,828.27	
Total—All Tracts:						
Gross rentals	\$ 468,606.07	\$ 83,480.81	\$ 135,563.37	\$ 169,676.57	\$ 77,476.51	\$ 2,408.81
Expenses	378,806.99	69,243.58	105,033.98	136,301.83	64,540.23	3,687.37
Net rental income..	\$ 89,799.08	\$ 14,237.23	\$ 30,529.39	\$ 33,374.74	\$ 12,936.28	\$ (1,278.56)

Note: Does not include any pro rata of Adminstrative expenses totaling\$152,884.88 \$ 16,546.32 \$ 15,204.80 \$ 20,190.91 \$ 58,675.23 \$ 42,267.62

*Purchased from Western Homes, Inc.

EXHIBIT No. 3

Pacific Homes, Inc.

Profit from Real Property Sales
(Organization to liquidation of the company)

	Total	June 1/42 to May 31/43	June 1/43 to May 31/44	June 1/44 to May 31/45	June 1/45 to May 31/46	June 1/46 to Apr. 30/47
Homewood Tract:						
Sales proceeds\$	1,062,948.48	\$ 4,566.23	\$ 21,537.54	\$483,276.17	\$493,542.58	\$ 60,025.96
Costs and expense	794,888.76	3,324.39	17,365.54	410,449.63	332,442.20	31,307.00
Profit on sale\$	268,059.72	\$ 1,241.84	\$ 4,172.00	\$ 72,826.54	\$161,100.38	\$ 28,718.96
Southwood Tract:						
Sales proceeds\$	454,028.72			\$ 16,393.03	\$385,330.29	\$ 52,305.40
Costs and expense	349,374.48			14,038.27	296,676.05	38,660.16
Profit on sale\$	104,654.24			\$ 2,354.76	\$ 88,654.24	\$ 13,645.24
Shoreview Tract:						
Sales proceeds\$	389,056.89		\$ 38,146.09	\$ 5,447.48	\$338,613.32	\$ 6,850.00
Costs and expense	292,078.45		32,998.44	4,587.98	249,643.61	4,848.42
Profit on sale\$	96,978.44		\$ 5,147.65	\$ 859.50	\$ 88,969.71	\$ 2,001.58
Westwood Tract:						
Sales proceeds\$	103,989.66				\$ 10,711.07	\$ 93,278.59
Costs and expense	79,564.09				10,102.78	69,461.31
Profit on sale\$	24,425.57				\$ 608.29	\$ 23,817.28
Bayshore Park Tract:						
Sales proceeds\$	6,331.37					\$ 6,331.37
Costs and expense	3,855.74					3,855.74
Profit on sale\$	2,475.63					\$ 2,475.63
Morey Tract:						
Sales proceeds\$	243,949.65				\$237,354.96	\$ 6,594.69
Costs and expense	253,547.61				246,916.62	6,630.99
Profit on sale\$	(9,597.96)				\$ (9,561.66)	\$ (36.30)
Total—All Tracts:						
Sales proceeds\$	2,260,304.77	\$ 4,566.23	\$ 59,683.63	\$505,116.68	\$1,465,552.22	\$225,386.01
Costs and expense	1,773,309.13	3,324.39	50,363.98	429,075.88	1,135,781.26	154,763.62
Profit on sale\$	486,995.64	\$ 1,241.84	\$ 9,319.65	\$ 76,040.80	\$ 329,770.96	\$ 70,622.39

Note: Does not include any pro rata of Administrative expenses totaling\$ 152,884.88 \$ 16,546.32 \$ 15,204.80 \$ 20,190.91 \$ 58,675.23 \$ 42,267.62

EXHIBIT No. 4

Pacific Homes, Inc.

**Investment in Real Property and
Notes and Mortgages Payable**

	May 31/42	May 31/43	May 31/44	May 31/45	May 31/46	May 31/47
Investment in Improved Property:						
Cost	\$660,374.49	\$1,255,907.28	\$920,731.94	\$147,602.68		
Less allowance for depreciation	15,743.50	38,846.29	46,286.95	6,121.85		
Depreciated cost ..	\$644,630.99	\$1,217,060.99	\$874,444.99	\$141,480.83		
Construction in progress	\$159,468.98			122,528.13	81,428.45	
Materials for construction	65,890.37					
Subdivided lots					40,353.51	
	<u>\$225,359.35</u>	<u>\$644,630.99</u>	<u>\$1,217,060.99</u>	<u>\$996,973.12</u>	<u>\$263,262.79</u>	
Federal Housing Administration, 4½% Loan	\$188,200.00	\$764,735.72	\$1,312,968.40	\$972,683.66	\$144,514.73	
	<u><u>\$188,200.00</u></u>	<u><u>\$764,735.72</u></u>	<u><u>\$1,312,968.40</u></u>	<u><u>\$972,683.66</u></u>	<u><u>\$144,514.73</u></u>	

Note: At April 30, 1947, such houses as were not sold were assigned to and such loans as were not paid were assumed by Ross H. Chamberlain, Ltd.:

Improved real estate	\$ 26,731.65
Federal Housing Administration loans	\$ 5,207.98

EXHIBIT No. 5

Pacific Homes, Inc.—Homewood Tract
Summary Showing Sales of Houses, All But One
of Which (Footnote e) Were Originally Occupied by Tenants
Under Leases With 30-Month Options to Purchase
(Homewood Tract)

Month and Year	Col. 1	Col. 2	Col. 3	Col. 4	Col. 5
	Sales to Tenants Purchasing Options	Sales Made After House Terminated and New Tenant Under Simple Purchase Option	Sales Made More Than 30 Months after Option Executed and Not Included in Columns 1 or 2	All Other Sales	Number of Houses on Hand from Date House Completed (Sept. 1/42) to Date House Sold
1942					
June					50
July					89
August					156
September					212
October					212
November					212
December					212
1943					
January					212
February					212
March					212
April	1				212
May	1				211
June	2				209
July					209
August					209
September					209
October					209
November	1				209
December					14
1944					
January				1(a)	15
February				1(a)	16
March				1(a)	16
April				1(a)	16
May				1(a)	16
June	1			1(a)	206
July	1			1(a)	206
August	1			1(a)	206
September	1			1(a)	206
October	1			1(a)	206
November	9			1(a)	206
December	8			1(a)	206
1945					
January	8			16	28
February	12			16	28
March	19			16	29
April	17	3		15	30
May	7	3		13	31
June	9			11	32
July	7			11	32
August	9	2	1	11	32
September	4	1	1	11	32
October	2	1	1	11	32
November	5	3	1	11	32
December	2	2		11	32
1946					
January	1	5	1	1(a)	55
February	2	5	2	1(a)	44
March	1	10	1	1(a)	38
April	2	5	1	1(b)	42
May	7	7	1	1(b)	25
June	5	37	1	1(b)	43
July			1	1(b)	18
August	4		1	1(b)	44
September			0	1(c)	45
Totals	141	55	7	1(c)	47
					9
					9

(a) These houses were sold less than 30 months after the last purchase option agreement was executed.

(b) Unable to ascertain complete lease history. However, houses were completed and sold respectively June 1, 1942—May, 1945 and July, 1942—June, 1946, periods of 37 and 47 months. Original purchase option lease agreements were dated August, 1942, and September, 1942, respectively.

(c) This house does not show evidence of a signed lease agreement. However, it was completed in August, 1942, and sold in August, 1945, a period of 36 months.

(d) Construction commenced approximately January, 1942.

(e) Construction completed approximately September, 1942.

EXHIBIT No. 6

Pacific Homes, Inc.—Southwood Tract

Summary Showing Sales of Houses at Southwood Tract—None of Which Were Ever Occupied by Tenants Under Leases With Options to Purchase

Month and Year	Sales to Non-tenants	Sales to Tenants	Number of Houses on Hand First of Each Month	Number of Months from Date House Completed (January 1, 1944) to Date House Sold
1944				
January			72	
February			72	
March			72	
April			72	
May			72	
June			72	
July			72	
August			72	
September			72	
October			72	
November			72	
December			72	
1945				
January			72	
February			72	
March			72	
April		2	72	15
May	5(a)	1	70	16
June		1	69	17
July	1		63	18
August	1		62	19
September	3		61	20
October	3		58	21
November	5	1(b)	55	22
December	1		49	23
1946				
January	2		48	24
February	3		46	25
March	7	7	43	26
April	7	3	29	27
May	12		19	28
June	4	3	7	29
July	1		0	30
Totals	<hr/> 55	<hr/> 18	<hr/> =	<hr/> =

(a) One of these was sold to the manager of the tract who had been allowed to transfer his option from the Homewood tract.

(b) Sold twice.

Construction commenced approximately August, 1943.

Construction completed approximately January, 1944.



EXHIBIT No. 7

Pacific Homes, Inc.—Shoreview Tract
 Summary Showing Sales of Houses at Shoreview Tract—None
 of Which Were Ever Occupied by Tenants Under Leases With
 Options to Purchase

Month and Year	Sales to Nontenants	Sales to Tenants	(a) Other	Number of Houses on Hand	Number of Months from Date House Completed (February 1, 1944) to Date House Sold
				First of Each Month	
1943					
October				1	
November				4	
December				2	
1944					
January				53	
February				56	
March				56	
April				56	
May				56	
June				56	
July				56	
August				56	
September				56	
October				56	
November				56	
December				56	
1945					
January				56	
February				56	
March				56	
April	1			56	14
May				55	
June	2			55	16
July				53	
August	5			53	18
September	1	1		48	19
October	2			46	20
November	5			44	21
December	1	5		39	22
1946					
January	3	1		33	23
February	3	7		29	24
March	10	2		19	25
April	2			7	26
May	3	1		5	27
June	1			1	28
July				0	
Totals	38	18	7		
	=	=	=		

(a) This column represents sales where no written lease agreements were located in the file for each house.

Construction commenced approximately July, 1943.

Construction completed approximately February, 1944.

[Endorsed]: Filed December 13, 1954.

[Title of District Court and Cause.]

MEMORANDUM OPINION

This is an action to recover taxes which it is alleged were erroneously or illegally collected from plaintiff.

Roche, Chief Judge:

Ross Chamberlain and David O. Bohannon were the organizers and sole stockholders of Pacific Homes, Inc., Western Homes, Inc., Greenwood Corporation and Rollingwood Corporation. Each corporation followed a business pattern of renting defense housing to war workers (generally with an option to purchase) and then selling off the houses either to option holders or to others willing to buy.

Plaintiff's position is that the profits which resulted from their sales of defense housing were subject to the capital gains tax of 25% under Section 117 (j) of the U. S. Internal Revenue Code. Defendant claims that the profits from the sales of defense housing should be taxed at ordinary income and excess profits tax rates in the same manner as if the houses constituted property held by plaintiff primarily for sale to customers in the ordinary course of its trade of business.

This specific issue has been considered by our Ninth Circuit Court of Appeals in two cases, Rollingwood Corporation v. Commissioner of Int. Rev. (1951), 190 F. 2d 263; Lucille McGah v. Commissioner of Int. Rev. (1954), 210 F. 2d 769.

In the Rollingwood Case the Tax Court found that the corporation held its houses primarily for sale to customers in the ordinary course of its trade or business within the meaning of Section 117 (j); therefore, the profit from these sales was taxable as ordinary income and not as capital gain.

In McGah v. Commissioner, 210 F. 2d 769, a different situation existed than in the instant case. In that case it clearly appeared that the builder was forced to sell some of his houses in order to liquidate an excessive bank indebtedness. Further, even at the time of trial the taxpayer continued to be engaged in the rental business. The court expressed the view that petitioner constructed the houses primarily for investment purposes, and went on to state that it found no support for the conclusion that the taxpayers had changed their admitted purpose of holding their properties for rental.

Certainly, there may be a change of intent between the time of acquisition of property and the time of sale, i.e., the taxpayer may originally build houses for investment and then by frequent sales in later years demonstrate that renting had been forsaken and that the properties were then being held primarily for sale to customers. This occurred in the instant case, and is evidenced by both the expressed intent and the actual activities of the taxpayer. As early as December 9, 1943, before the corporation had made many sales, the intention to engage in the sale of houses was stated by the chairman of the Board of the corporation and an ap-

propriate resolution was adopted authorizing future sales and ratifying previous sales. The minutes of the special meeting of the Board of Directors of December 9, 1943, are persuasive evidence of the actual intention of the corporation to engage in the business of selling houses. Once this decision to sell was made Pacific Homes made frequent, continuous sales of the housing. As stated in the Rollingwood case such activity is ample to support a finding that the corporation was in the business of selling real property.

Out of the total of 347 houses built by Pacific Homes, Inc., 7 were immediately sold and 212 were immediately rented with options in the renters to buy. Such houses necessarily were held by the corporation from the very beginning for sale to the tenants, if the tenants decided to buy. The corporation voluntarily chose this method of doing business and they had no alternative but to sell when the options were exercised. It was therefore in the course of its ordinary business to sell to tenants who exercised their options to buy. The exhibits show that 141 options were exercised by tenants of Pacific Homes. It can be seen that renting the houses with options in the tenants to purchase was itself an effective sales device. In the period from June, 1942, to September, 1946, Pacific Homes sold every one of the 347 houses it had built.

The most that can be said in plaintiff's favor, considering all of the evidence, is that it intended to

pursue whichever activity, renting or selling, proved more profitable, i.e., if the rental market were good they would continue to rent, but if the sales market were high they would sell. Under the Rollingwood decision, such intention is sufficient to make the profit from sales taxable as ordinary income.

It is urged that the procedure followed by plaintiff in disposing of a rental operation certainly did not follow the pattern of advertising and other sales promotion techniques used by real estate firms holding real estate primarily for sale to customers in the ordinary course of their trade or business. However, Mr. Chamberlain readily explained that the reason for this was the fact that the houses sold themselves. Thus, it was not necessary for the corporation to engage in an extensive advertising or selling campaign. When one considers the volume of houses sold, there is no question of the truth of the statement that these houses "sold themselves." According to Mr. Chamberlain, even the decision not to put up "for sale" signs had a sales motive in that a commodity in apparently "scarce" supply is more attractive to a buyer.

Viewing the acitvities of plaintiff in light of the legislative purpose and policy this court concludes that the houses in question were held by Pacific Homes primarily for sale to its customers in the ordinary course of its trade or business, and that the gain from sales thereof should be taxed as ordinary income.

In accord with the above reasoning

It is Hereby Ordered that judgment be entered herein upon findings of fact and conclusions of law in favor of the defendant, United States of America, and that the respective parties pay their own costs.

Date: February 2, 1955.

/s/ MICHAEL J. ROCHE,
Chief Judge,
U. S. District Court.

[Endorsed]: Filed February 2, 1955.

[Title of District Court and Cause.]

FINDINGS OF FACT AND CONCLUSIONS OF LAW

The above-entitled case came on for trial on December 13, 1954, plaintiff being represented by L. W. Wrixon, Esq., and Carl R. Schulz, Esq., and defendant being represented by Lloyd H. Burke, Esq., United States Attorney, and George A. Blackstone, Esq., Assistant United States Attorney. A stipulation of facts was filed, oral and documentary evidence were introduced, and the case was argued orally and on briefs. The Court having filed its memorandum order for judgment for defendant on February 2, 1955, the Court now makes the following Findings of Fact and Conclusions of Law:

Findings of Fact

1. This action is brought pursuant to 28 U.S.C., Section 1346(a)(1) by plaintiff against defendant

United States of America for the refund of corporate excess profits taxes for the fiscal year ending May 31, 1945, in the alleged sum of \$18,741.37 plus interest; for the refund of corporate income taxes for the same fiscal year in the alleged sum of \$4,065.53 plus interest; for the refund of corporate excess profits taxes for the fiscal year ending May 31, 1946, in the alleged sum of \$111,151.11 plus interest; and for the refund of corporate income taxes for the fiscal year ending May 31, 1947, in the alleged sum of \$7,083.47 plus interest.

2. Plaintiff was incorporated under the laws of California on August 9, 1941, and was dissolved on May 31, 1947. Twenty-sixes shares of plaintiff's stock were originally issued to David D. Bohannon who sold such shares to plaintiff's treasury on May 10, 1945. Twenty-four shares of plaintiff's stock were originally issued to Ross H. Chamberlain who, after May 10, 1945, was the sole stockholder of plaintiff corporation.

3. Plaintiff was organized for the purpose of engaging in the business of developing real estate subdivisions and renting and selling houses primarily to defense workers. Plaintiff so described its business on its federal tax returns, and plaintiff did in fact engage in such business during the period herein issue.

4. On or about September 1, 1942, plaintiff completed the construction of 212 single-family dwelling houses in a subdivision known as "Homewood Tract." On or about January 1, 1944, plaintiff com-

pleted the construction of 72 single-family dwelling houses in a subdivision known as "Southwood Tract." On or about February 1, 1944, plaintiff completed the construction of 63 single-family dwelling houses in a subdivision known as "Shoreview Tract."

5. Seven of the houses in the Shoreview Tract were sold in the last three months of 1943 immediately upon construction. All 212 houses in the Homewood Tract were initially rented after construction to defense workers under leases containing options in the tenants to purchase the houses within 30 months. All of the houses in the Southwood Tract and the unsold houses in the Shoreview Tract were initially rented after construction without options in the lessees to buy the houses.

6. On December 9, 1943, the Board of Directors of plaintiff authorized the future sale of plaintiff's houses and ratified past sales. At that meeting the Chairman of the Board of Directors of plaintiff expressed the intention of plaintiff to sell its houses. Thereafter plaintiff's intention was to pursue whichever activity, renting or selling, proved more profitable.

7. Renting the Homewood Tract houses with purchase options in the tenants was an effective sales device in that it created a ready-made sales market for those houses. Such houses were necessarily held for sale to tenants if they decided to exercise their options. Plaintiff voluntarily and without any compulsion from Federal Governmental agencies or other third parties granted the options

to buy to the lessees of the Homewood Tract houses. Renting with option to buy was a method of doing business. In renting the Homewood Tract houses with options to buy, plaintiff was pursuing the same method of doing business as Western Homes, Inc., Rollingwood Corporation and Greenwood Corporation, which corporations were initially wholly owned and managed by the same two stockholders who initially owned and managed plaintiff corporation.

8. After several months of rental experience, plaintiff found it to be unprofitable to continue to rent any of its houses. Plaintiff thereupon decided to hold all of its houses in the Homewood, Southwood and Shoreview Tracts primarily for sale to customers in the ordinary course of business in addition to those houses in the Homewood Tract which were already held by plaintiff primarily for sale under outstanding lease-option agreements. The tract managers were then instructed by plaintiff to sell the houses as they became vacant. There was no economic pressure placed upon plaintiff by Federal Governmental agencies or other third parties to sell the houses. The decision to sell all of its houses was voluntarily made by plaintiff for the purpose of maximizing its profits in the ordinary course of its trade or business. The sales here in issue took place after the decision was made to hold the houses primarily for sale.

9. Commencing in June, 1944, and continuing through April, 1946, 137 houses in the Homewood

Tract were sold to tenants exercising options in their leases to purchase. Commencing in April, 1945, and continuing through August, 1946, the remaining 69 houses in the Homewood Tract were sold to persons without options to buy.

10. Commencing in April, 1945, and continuing through July, 1946, all 72 houses in the Southwood Tract were sold.

11. Commencing in April, 1945, and continuing through June, 1946, all remaining 56 houses in the Shoreview Tract were sold.

12. The sales of the houses in the Homewood, Southwood and Shoreview Tracts were frequent and continuous during the tax years in question, and all of the houses in those tracts had been sold by the end of August, 1946.

13. In addition to the sales of houses in Homewood, Southwood and Shoreview Tracts, plaintiff sold all of its houses in three other tracts, not here in issue, during the fiscal years ending May 31, 1946, and May 31, 1947, plaintiff having acquired such other tracts in its fiscal year ending May 31, 1946. Plaintiff went out of business and dissolved on May 31, 1947.

14. Because of the wartime and postwar demands for houses, plaintiff's houses were sold without the necessity of engaging in extensive advertising or sales campaigns. The houses in effect sold themselves. The absence of "For Sale" signs on the tracts had a sales motive and was a deliberate sales techni-

que of plaintiff to give prospective customers a sense of scarcity of available houses for sale and thereby make the house being sold seem more desirable. Most of the sales were made by plaintiff's salaried tract managers but where their efforts were not sufficient, sales were effected through real estate brokers on a commission basis. Plaintiff's selling activities under the circumstances, together with the frequency and continuity of sales, were sufficient to constitute a trade or business of selling houses.

15. The houses in the Homewood Tract which were sold to tenants pursuant to options to buy were held primarily for sale to customers in the ordinary course of plaintiff's trade or business from the time the lease-option agreements were executed.

16. The houses in the Homewood Tract which were sold to persons without options to buy and the houses in the Southwood and Shoreview Tracts here in issue were held primarily for sale to customers in the ordinary course of plaintiff's trade or business from the time when the decision was made, prior to the sales in question, to sell all houses as they became vacant including those not then subject to lease-option agreements.

Conclusions of Law

1. Income received by plaintiff from the sale of its houses during its fiscal years ending May 31, 1945; May 31, 1946, and May 31, 1947, was taxable as ordinary income and not as capital gain.

2. The Commissioner of Internal Revenue correctly and lawfully determined the tax liability of plaintiff for its fiscal years ending May 31, 1945; May 31, 1946, and May 31, 1947.

3. Defendant is entitled to judgment herein against plaintiff, dismissing its complaint and the claims therein stated with each party to pay its own costs.

Let judgment be entered accordingly.

Dated: February 16th, 1955.

/s/ MICHAEL J. ROCHE,
United States District Judge.

Affidavit of Mail attached.

Lodged February 9, 1955.

[Endorsed]: Filed February 16, 1955.

In the United States District Court for the Northern
District of California, Southern Division
Civil No. 31368

PACIFIC HOMES, INC., a California Corpora-
tion,

Plaintiff,

vs.

UNITED STATES OF AMERICA,

Defendant.

JUDGMENT

This cause came on regularly to be heard without
a jury before the above-entitled Court, the Hon-

able Michael J. Roche presiding, on December 13, 1954. Plaintiff appeared by L. W. Wrixon, Esq., and Carl R. Schulz, Esq. Defendant appeared by Lloyd H. Burke, Esq., United States Attorney, and George A. Blackstone, Esq., Assistant United States Attorney. The stipulation of facts was filed, oral and documentary evidence were introduced, and the Court having made its findings of fact and conclusions of law,

Now Therefore, by reason of the law and the evidence and the findings of fact and conclusions of law aforesaid,

It is Hereby Ordered, Adjudged and Decreed that plaintiff take nothing by its action and that its complaint and the claims therein stated be and the same are dismissed without costs.

Dated: February 16, 1955.

/s/ MICHAEL J. ROCHE,
Judge, United States District
Court.

Lodged February 9, 1955.

[Endorsed]: Filed February 16, 1955.

[Title of District Court and Cause.]

NOTICE OF APPEAL

Notice is Hereby Given that Pacific Homes, Inc., a California corporation, plaintiff above named,

hereby appeals to the United States Court of Appeals for the Ninth Circuit from the final judgment entered in this action on February 17, 1955.

Dated: March 10th, 1955.

/s/ L. W. WRIXON,

/s/ CARL R. SCHULZ,

Attorneys for Plaintiff.

Receipt of Copy acknowledged.

[Endorsed]: Filed March 10, 1955.

The United States District Court, Southern District
of California, Southern Division

No. 31368

PACIFIC HOMES, INC., a California Corpora-
tion,

Plaintiff,

vs.

THE UNITED STATES OF AMERICA,

Defendant.

Before: Hon. Michael J. Roche, Judge.

**REPORTER'S TRANSCRIPT ON APPEAL
PROCEEDINGS ON TRIAL**

Appearances:

For Plaintiff:

L. W. WRIXON, ESQ., and
CARL R. SCHULZ, ESQ.

For the Government:

LLOYD H. BURKE, ESQ.,
United States Attorney, By
GEORGE BLACKSTONE, ESQ.,
Assistant U. S. Attorney.

* * *

OPENING STATEMENT ON BEHALF OF THE PLAINTIFF

Mr. Wrixon: If it may please your Honor, there are two cases which are before the Court. One is Pacific Homes, Inc., vs. United States, and the other is Western Homes, Inc., vs. United States. Both of the cases involve the same principle.

With your Honor's permission, I would prefer to refer first to the Pacific Homes, Inc., and then to the Western Homes, Inc.

The case of Pacific Homes, Inc., is a suit by the plaintiff, a California corporation, to recover certain Federal income and Federal excess profits taxes which the plaintiff contends were erroneously and illegally collected [3*] by the defendant for the plaintiff's fiscal years ended May 31st, 1945, May 31st, 1946, and May 31st, 1947. The corporation was organized prior to those years, but during the years 1943 and 1944, although it was an operating organization, there did not result in its operations any problem concerning taxes which is now before the Court.

*Page numbering appearing at top of page of original Reporter's Transcript of Record.

During the years 1943 and 1944 the plaintiff caused houses to be constructed for rental to war workers. The plaintiff leased these houses to war workers and ultimately sold the houses in these various tracts. Much of the story, factually, is told by the stipulation which has been entered into by the parties and certain exhibits which are attached to the stipulation.

With your Honor's permission I propose to read into the record the stipulation of facts which has been entered into and at this time will not include in my opening remarks a number of factual matters which might otherwise be included in an opening statement.

Witnesses will be available to explain the exhibits which are attached to the stipulation, and to explain the circumstances under which the houses were constructed by the plaintiff and rented and ultimately sold.

In general, between the date of the incorporation of the plaintiff and the date of its final liquidation, the plaintiff collected an aggregate of approximately \$469,000 in rents, [4] against which it paid some \$379,000 in expenses—direct expenses, that is—leaving a net rental income of approximately \$90,000. Statements are attached to the stipulation showing in detail the amount of those rents, segregated as between the various tracts, and the amount of the expenses, allocated likewise to the various tracts.

Statements are also being presented showing by months the sales of houses that were made by the plaintiff from three of its tracts. These three tracts

are the Homewood Tract, which was completed approximately September 1st, 1942, and involved 212 houses; the Southwood Tract, which was completed approximately January 1st, 1944, involving 72 houses; and the Shoreview Tract, which was completed approximately February 1st, 1944, involving 63 houses.

During the Fiscal Years ended May 31st, 1945, May 31st, 1946, and May 31st, 1947, the plaintiff sold some of these houses from the three tracts to which I have just made reference. These sales during these three fiscal years represented the sales of houses which had been held for more than six months at the time of sale. The plaintiff represented the profit on these sales on its Federal income and excess profits tax returns as long-term capital gains. The defendant has assessed and collected taxes on the ordinary income and excess profits tax returns on the gains from the sales of these houses. [5]

In addition to the sales of the houses out of the Homewood, the Southwood and Shoreview Tracts, which were held over six months, the plaintiff sold certain other property, the proceeds of which, however, are not involved in this case taxwise because the properties other than the Homewood, Southwood and Shoreview properties were properties which had not been held for six months at the time of sale. This latter type of sale was represented either as ordinary income or as short-term capital gains, and accordingly these sales are not involved in this proceeding.

The sole issue in the case, as the plaintiff sees it, is how the net gains from the sales in Homewood,

the Southwood and the Shoreview tracts should be taxed; that is, whether the plaintiff should be taxed on these sales as long-term capital gains and as a limited rate of tax applicable to those properties, or whether, as the Government contends, the gains from the sales of these houses should be treated as just like any other ordinary income, and should be taxed in ordinary returns and excess profits returns, which are greatly in excess of the capital gains return.

The statute which is involved in this case is Section 117(J) of the United States Internal Revenue Code—that is, the 1939 Code and not the 1954 Code. With your Honor's permission, I should like to make a short reference to the Section. The Section is in three parts and I will read from [6] Section 2.

First, it states the general rule:

"If, during the taxable year, the recognized gains upon sales or exchanges of property used in the trade or business, plus the recognized gains from the compulsory or involuntary conversion (as a result of destruction in whole or in part, theft or seizure, or an exercise of the power of requisition or condemnation or the threat or imminence thereof) of property used in the trade or business and capital assets held for more than six months into other property or money, exceed the recognized losses from such sales, exchanges, and conversions, such gains and losses shall be considered as gains and losses from sales or exchanges of capital

assets held for more than six months. If such gains do not exceed such losses, such gains and losses shall not be considered as gains and losses from sales or exchanges of capital assets.”

Now, Section 1 defines the term “Property Used in the Trade or Business.” Section 1 reads in part:

“For the purposes of this sub-section, the term ‘Property Used in the Trade or Business’ means property used in the trade or business of a [7] character which is subject to the allowance for depreciation provided in Section 23(1) held for more than six months, and real property used in the trade or business, held for more than six months, which is not (A) property of a kind which would properly be includable in the inventory of the taxpayer if on hand at the close of the taxable year, or (B) property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, or (C) a copyright, a literary, musical or artistic composition, or similar property, held by a taxpayer described in Sub-section (a)(1)(C).”

The issue, then, before the Court is whether the real property which was sold by this plaintiff during the three taxable years just mentioned constitutes property which may be classified under Section 117(J) as property entitled to the capital gain treatment or whether the property is of the type that is referred to in the section as being owned primarily for sale to customers in the ordinary course of its trade or business.

A memorandum has been prepared for submission to your Honor which lists a number of the cases which have caused this issue. Your Honor may be familiar with those cases in our Ninth Circuit which have considered this question. One is [8] the Rollingwood case—Rollingwood Corporation versus Commissioner of Internal Revenue, 190 Fed. 2d 263, decided on June 21st, 1951.

And another case, also in our Ninth Circuit, is Lucille McGah vs. Commissioner of Internal Revenue, 193 Fed. 2d, 662, decided January 4th, 1952; and a second appeal in the very same case decided by our Ninth Circuit on February 18, 1954, at 200 Fed. 2d, 769.

There are decisions on this issue in other jurisdictions. We have prepared a memorandum for submission to your Honor which includes as an exhibit a reprint of an article on this subject which refers to and analyzes a number of cases, some of which are in favor of the Government, some of which are in favor of the taxpayer. The article also outlines certain factors which the courts have taken into consideration in determining whether in this type of case the property was entitled capital gains treatment or should be regarded as property owned primarily for sale in the course of the trade or business.

The Court: Did you serve a copy on your opponent?

Mr. Wrixon: Yes, your Honor.

OPENING STATEMENT ON BEHALF OF THE GOVERNMENT

Mr. Blackstone: May it please the Court, I intend to be very brief:

Both of these causes involve a very simple question of [9] fact for your Honor to decide. In each case the question is, did the taxpayer hold these houses for sale primarily to customers in the regular course of its trade or business?

We are maintaining that these two cases, Pacific Homes, Inc., vs. United States, and Western Homes Corporation vs. United States, are to all intents and purposes identical with the decision cited by Mr. Wrixon, Rollingwood Corporation vs. Commissioner of Internal Revenue. The parties involved, the stockholders, are the same; the whole scheme of both corporations involved in this litigation and Rollingwood are the same.

There is no substantial distinction of fact in these cases and the Rollingwood case, and I think your Honor, after you have read the Rollingwood case and compared it with the facts in this case, will be convinced the decision in the Rollingwood case is correct and is binding for all purposes in this litigation.

In the Rollingwood case the taxpayer corporation contested a deficiency assessment in the first instance, and went to the tax court for redetermination, and the tax court decided that the corporation held the houses primarily for sale to customers in the regular course of the trade or business; and

on appeal the Ninth Circuit Court affirmed that decision.

In these cases the two taxpayers elected to pay the deficiency assessment and are now suing in Federal Court for [10] refund.

I think it is important to bring to your Honor's attention at the outset the very important part of the decision of the Ninth Circuit in that Rollingwood case.

They stated there, Judge Bone writing the decision, that the word "primary"—"owned property primarily for sale"—"primarily" does not mean the only purpose of the business, or the first purpose or principal business. Judge Bone said those words in Section 117(J) of the Internal Revenue Code simply mean "substantial" or "essential." If one of their essential, fundamental, substantial purposes was to sell the houses they had constructed, then the profit from the sale of those houses should be taxed as ordinary income and not as capital gain.

The Court: Call your first witness.

Mr. Wrixon: If your Honor please, I would like at this time to offer the stipulation which has been entered into between the parties.

The Court: Read it into the record.

Mr. Wrixon: With your Honor's permission, might I read into the record the stipulation which has just been filed as a continuing memorandum of factual matters which I intentionally omitted in my opening statement, but which I think might well be before the Court at this time?

The Court: Embodied in this stipulation? [11]

Mr. Wrixon: Yes, your Honor.

The Court: Very well, proceed.

(Thereupon, Stipulation dated December 13, 1954, was read to the Court.)

Mr. Wrixon: If your Honor please, I appreciate that this is not the time to argue the case, but I can't help making a reference to the case of Rollingwood to which counsel referred in his opening statement.

When your Honor reads the case you will see that the Court very definitely points to the fact that 28 sales of houses were made in the first fiscal year and 178 sales in the second fiscal year of Rollingwood's existence to persons who did not have rental-option agreements, and that was stated to be a very important fact and very persuasive with respect to the—

Mr. Blackstone: I object to his arguing now the merits of the case. If he wants to present them at the proper time, it is perfectly all right. [12]

* * *

JAMES E. MOORE

was called as a witness on behalf of the plaintiff, and being first duly sworn to tell the truth, the whole truth and nothing but the truth, testified as follows:

* * *

Direct Examination

By Mr. Wrixon:

Q. Mr. Moore, did you prepare any exhibits in connection with the rental and the leasing of houses

(Testimony of James E. Moore.)
by Pacific Homes, Inc.? A. Yes.

Q. And will you state to the Court from what records of the plaintiff you prepared such data?

A. Well, I prepared it from the Sales Journal of the Corporation, and from various file folders which were kept for [13] each house, containing various information.

Mr. Wrixon: Counsel, I show you this folder (handing document to Mr. Blackstone).

Q. (By Mr. Wrixon): I will show you what purports to be a folder containing certain data, and will you state to the Court whether you have ever seen the folder and what the folder consists of?

A. Well, I have seen this folder and it consists of an application form for rental, and a lease agreement form, and other papers pertinent to the sale of the house.

Q. Does it state that the corporation maintained similar folders for other houses in the Southwood Tract? A. Yes.

Q. And is the folder which you have in your hand one of the folders which you examined in connection with the data which you have prepared for the Southwood Tract? A. Yes.

Mr. Wrixon: If your Honor please, I will offer in evidence as Plaintiff's exhibit next in order, a file folder relating to the Southwood Tract houses.

The Court: It may be admitted and marked.

Mr. Blackstone: Could that be numbered as the next one after the exhibits attached to the stipulation so that we won't get confused? I think there

(Testimony of James E. Moore.)

are seven exhibits attached to the stipulation which have already been numbered Exhibits [14] one through seven. If this could be Exhibit 8 and then followed from there on, it would be easier to keep them straight, I think.

Mr. Wrixon: That is satisfactory with the plaintiff.

The Court: Satisfactory to the clerk?

(Whereupon file folder referred to above was received in evidence and marked Plaintiff's Exhibit No. 8.)

PLAINTIFF'S EXHIBIT No. 8

[Plaintiff's Exhibit No. 8 is a folder containing the papers relating to the sale of a house in the Southwood Tract.]

Pacific Homes, Inc.

March 16th, '44.

Mr. and Mrs. Chet Harshman,
University Ave.,
Los Altos, Calif.

Dear Sir & Madam:

Receipt is hereby acknowledged of the sum of \$75.00 for the first and 12th months' rent of the dwelling located at No. 481 Southwood Ave., Sunny-

(Testimony of James E. Moore.)

vale, Calif., which dwelling you hereby agree to rent from Pacific Homes, Inc., for a period of 12 months from date at a rental of \$50.00 per month payable in advance on the first day of each calendar month.

The additional provisions set forth on the reverse side hereof are incorporated in and made a part of this agreement.

Yours very truly,

PACIFIC HOMES, INC.,

By /s/ G. M. BERGER.

Received and agreed to:

/s/ ARTHUR E. HARSHMAN.

Date.....

Rate.....

Deposit or Rent Is Not Refundable

Posted, DW.

Received March 17, 1954.

[Endorsed]: Filed December 13, 1954.

Q. (By Mr. Wrixon): Now, Mr. Moore, I will show you the stipulation which has been received by the Court, and particularly Exhibit No. 6 attached to the stipulation relating to the Southwood Tract, and I will ask you, did you prepare Exhibit 6?

(Testimony of James E. Moore.)

A. Yes.

Q. Will you state to the Court from what data you prepared Exhibit 6?

A. Well, it was from the file folders and the sales journal previously mentioned.

Q. Well, will you explain to the Court the data which you have shown on Exhibit 6, please?

A. Well, it shows the sales by month and year of 72 houses in the Southwood Tract. None of these houses were ever occupied by tenants who had leases with options to purchase. One of these houses was sold to the Manager of the tract, who had been allowed to transfer his option from the [15] Homewood Tract.

It also shows the number of houses owned at the first of each month. And in the last column it shows the period each house was held from the date of completion to date of sale.

In reference to that column you will see that fifteen houses—correction on that. You will see that seventy-two houses were held for fifteen months until sold.

In some instances that period might be longer than fifteen months because in preparing this schedule I have taken the completion date as the date at which the entire tract was completed, and also I have excluded the month of sale.

Q. May I interrupt you? Some of the houses might have been completed prior to the completion date set forth on the exhibit, is that right?

A. Yes.

(Testimony of James E. Moore.)

Mr. Blackstone: Just a minute. I object to his testifying what might have been. It seems to me he should state what appears in the folder, and I don't think it would be of any help for him to testify to speculative matters. If there is evidence on those facts, it can be produced by witnesses who know the facts.

Mr. Wrixon: Well, just explain to the Court the use of the date January 1, 1944, on the exhibit.

The Witness: That was the date the entire tract was [16] completed.

However, in examining these file folders, I would say that there was somewhere leases were executed prior to that date—I mean that the houses were completed prior to that date.

The Court: Does time enter into the merits of this matter?

Mr. Blackstone: Not so far as I am concerned; but it was just a matter of his testimony as to what might have been, and I didn't know what he was basing that on.

The Court: All right, proceed. The ultimate fact is that 72 houses were all sold on what date?

The Witness: Well, they were sold at various dates.

The Court: Final date, I mean?

The Witness: Finally they were sold in July of 1946, the last sales took place.

The Court: I see.

Q. (By Mr. Wrixon): Mr. Moore, I show you what purports to be another folder containing the

(Testimony of James E. Moore.)

same data, and I will ask you have you ever seen the folder and, if so, state to the Court what it includes.

A. Well, I have seen this folder and it pertains to the Shoreview Tract and contains a lease agreement form and other papers which are pertinent to the sale.

Q. Did you use the data in this folder in compiling any of [17] the statistical data concerning the Shoreview Tract? A. Yes.

Q. And did you examine other folders for each of the houses in the Shoreview Tract containing similar data? A. Yes.

Mr. Wrixon: I will offer in evidence as Plaintiff's exhibit next in order the folder relating to the Shoreview Tract.

The Court: It may be admitted and take the next number.

(Whereupon folder relating to Shoreview Tract was received into evidence and marked Plaintiff's Exhibit No. 9.)

(Testimony of James E. Moore.)

PLAINTIFF'S EXHIBIT No. 9

[Plaintiff's Exhibit No. 9 is a folder containing the papers relating to the sale of a house in the Shoreview Tract.]

Job #35.

Lot #93.

Pacific Homes, Inc.
Shoreview Tract
San Mateo, Calif.

Date: Dec. 23, 1943.

Mr. and Mrs. Irving W. North,
441 Merritt Ave.,
Oakland, Calif.

Dear Sir & Madam:

Receipt is hereby acknowledged of the sum of \$63.36 for the first and 12th months' rent of the dwelling located at No. 1311 - 2nd Ave., San Mateo, Calif., which dwelling you hereby agree to rent from Pacific Homes, Inc., for a period of 12 months from date at a rental of \$50.00 per month payable in advance on the 1st day of each calendar month, at the San Francisco Bank, Burlingame Branch.

The additional provisions set forth on the reverse side hereof are incorporated in and made a part of this agreement.

Yours very truly,

PACIFIC HOMES, INC.,

By /s/ DORIS H. PINGREY.

(Testimony of James E. Moore.)

1st Mo., 13.36

12th Mo., 50.00

63.36

Received and agreed to:

/s/ IRVING W. NORTH,

/s/ MRS. GRACE NORTH.

Date.....

Rate.....

Deposit or Rent Is Not Refundable

Received January 10, 1944.

[Endorsed]: Filed December 13, 1954.

Q. (By Mr. Wrixon): Now, Mr. Moore, I will show you Exhibit 7 attached to the stipulation and ask you, did you prepare Exhibit 7? A. Yes.

Q. And did you prepare Exhibit 7 from—partially from the data contained in the folder, one of which has just been admitted into evidence?

A. Yes.

Q. Did you examine all the folders in the Shoreview Tract in order to prepare Exhibit 7, attached to the stipulation? A. Yes.

Q. Will you explain the data contained in Exhibit 7 to the Court, please? [18]

A. Well, it shows the sales by month and year of these 63 houses in the Shoreview Tract. None of

(Testimony of James E. Moore.)

these houses were ever occupied by tenants who had leases with option to purchase.

It also shows that in the column headed "Other" with an (a) there were seven houses sold immediately or shortly after completion.

Q. Does the statement show when the next sale was made, Mr. Moore?

A. Yes. The next sale was made in April of 1945.

Q. Does the statement also show when the last house in that tract was sold?

A. Yes. That was June of 1946. The exhibit also shows the number of houses held the first of each month, and in the last column it shows the number of months the house was held from completion date until sold. That completion date is the date the entire tract was completed. And as I had mentioned previously, the period held could be longer than as shown in that column because of the fact that——

Mr. Blackstone: I object to that form of testimony and ask it be stricken. He should testify what exists in the folder relating to those exhibits.

Q. (By Mr. Wrixon): Do you see in the folder any leases indicating a date prior to the date of completion used in preparing the exhibit? [19]

A. Yes. Also in computing this period I did not include the month of sale.

Q. Mr. Moore, I will show you what purports to be a folder containing certain data and ask you to state to the Court whether you have ever seen that folder and, if so, what it contains?

A. Well, I have seen this folder before, and it

(Testimony of James E. Moore.)

contains information relating to a house in the Homewood Tract. There is a form of application for rental, and a lease agreement form, and other information relating to the sale of the house.

Q. Did you examine a similar folder for other houses in the Homewood Tract? A. Yes.

Q. And did you use the data contained in those folders in part in preparing an exhibit with respect to the Homewood Tract? A. Yes.

Mr. Wrixon: And, if your Honor please, I will offer in evidence as Plaintiff's exhibit next in order a folder relating to the Homewood Tract.

The Court: These various folders, who had them? Who was responsible for them?

Mr. Wrixon: Will you state to the Court whether those folders were the folders of the plaintiff, Pacific Homes?

A. Yes, they were. [20]

Mr. Wrixon: Is there any other question, your Honor?

The Court: Where did you get them?

The Witness: Well, they were being kept in the garage of Mr. Chamberlain.

The Court: This is a resume or digest of the business done by these various corporations?

The Witness: Yes. Relating to these houses.

The Court: All right, let it be admitted and marked.

(Thereupon folder relating to Homewood Tract was received in evidence and marked Plaintiff's Exhibit No. 10.)

(Testimony of James E. Moore.)

PLAINTIFF'S EXHIBIT No. 10

[Plaintiff's Exhibit No. 10 is a folder containing the papers relating to the sale of a house in the Homewood Tract.]

Pacific Homes, Inc.

Homewood

Date: Feb. 6, 1944.

Mr. and Mrs. Lester I. Parker,
Glenallen, Calif.

Dear Sir & Madam:

Receipt is hereby acknowledged of the sum of \$81.00 for the first and 12th months' rent of the dwelling located at No. 338 Orchard Ave., Sunnyvale, Calif., which dwelling you hereby agree to rent from Pacific Homes, Inc., for a period of 12 months from date at a rental of \$45.00 per month payable in advance on the 1st day of each calendar month.

The additional provisions set forth on the reverse side hereof are incorporated in and made a part of this agreement.

Yours very truly,

PACIFIC HOMES, INC.,

By /s/ P. C. MARSHALL, by L.L.

(Testimony of James E. Moore.)

Received and agreed to:

/s/ LESTER I. PARKER,

/s/ MILLICENT PARKER.

Date: 2/6/44.

Rate.....

Block 6.

Job 204.

Lot 24.

Deposit or Rent Is Not Refundable

Posted: M. Pascal.

[Endorsed]: Filed December 13, 1954.

Q. (By Mr. Wrixon): These folders to which you have just made reference, were they used by you in preparing Exhibit 5 attached to the stipulation, referring the Homewood Tract, Mr. Moore?

A. Yes.

Q. Will you state to the Court the meaning of the data contained in Exhibit 5 attached to the stipulation?

A. Well, it is an exhibit showing the sales by month and year of the 212 houses in the Homewood Tract.

The Court: Dates?

The Witness: The date, your Honor?

(Testimony of James E. Moore.)

The Court: Yes.

The Witness: Well, the last sale took place August of 1946. The first sale took place April of 1943. All but one [21] of these houses was originally occupied by tenants who had leases with 30-month options to purchase. Column 1 shows the sales to these tenants who had options to purchase and who exercised them.

Columns 2, 3 and 4 show sales to persons who did not have options to purchase.

Column 2 shows instances where after the original—or qualifying it, where the option had terminated, the house was then rented to a tenant without a purchase option.

Q. (By Mr. Wrixon): What was the date of the first sale of that type of case, Mr. Moore?

A. That was April of 1945. I may want to correct that. The first sale was in December of 1943, and then there was another sale in January, 1944, and then the sale took place as previously mentioned, April of 1945.

Now, in Column 3 are sales which were made more than 30 months after the last purchase option agreement had been executed.

And in Column 4 are various sales which were broken down as to six which had been sold less than 30 months after the last purchase option agreement was executed. There are two where I was unable to determine a complete leasing history. However, these two homes were held for periods of 37 and 47 months, respectively. Then there was one house

(Testimony of James E. Moore.)

which did not show evidence of a signed lease agreement. However, it was [22] held for 36 months.

Q. That data is shown in what column?

A. In Column 4, which shows a total of 9 houses. Column 5 shows the number of houses held the first of each month. And in Column 6 I have shown the number of months the house was held from date of completion of the entire tract to the date the house was sold.

Q. Now, Mr. Moore, did you make any tabulation of the leases shown in the Homewood, the Southwood and Shoreview Tracts to indicate the number of leases that were executed and the terms for which the leases were executed? A. Yes.

Q. I will show you what purports to be a statement entitled "Data re: Number and Types of Leases," and will ask you to examine the statement and state to the Court whether you prepared it?

A. Yes, I prepared this.

Q. From what material did you prepare it?

A. From the file folders that I examined.

Q. And the file folders contained leases which purported to be signed by tenants, is that correct?

A. Yes.

The Court: From one of these three folders?

The Witness: Well, from these and the other folders.

The Court: What other folders? [23]

The Witness: Well, there was a file folder for each house in each tract and those are the folders referred to.

(Testimony of James E. Moore.)

The Court: All right.

Mr. Wrixon: I will offer in evidence, if your Honor please, as Plaintiff's exhibit next in order a statement entitled "Data re: Number and Types of Leases."

The Court: It may be admitted and marked.

(Whereupon document above referred to was received in evidence and marked Plaintiff's Exhibit No. 11.)

PLAINTIFF'S EXHIBIT No. 11

Pacific Homes

Data Re Number and Types of Leases

	Total Leases Given	30 Month Option Leases	Total	Non-Option Leases	
				Month to Month	12 Months
Homewood tract.....	419	356	63	5	58
Southwood	89	None	89	None	89
Shoreview	63	None	63	None	63

At the Homewood tract the last option lease given was dated December 10, 1943, the first non-option lease was dated December 21, 1943.

[Endorsed]: Filed December 13, 1954.

Q. (By Mr. Wrixon): Now, Mr. Moore, will you explain to the Court the data which you have compiled on Plaintiff's Exhibit 11?

A. It shows a breakdown of the three tracts of Pacific Homes, showing the total leases given for each tract; and of that total how many were 30-

(Testimony of James E. Moore.)

month option leases, the total which were non-option leases, and a breakdown of the non-option leases as to their duration. And it also states that the last option lease given in the Homewood Tract was dated December 10, 1943, and the first non-option lease was dated December 21st, 1943.

Q. What does the exhibit state as to the length of the leases which were granted to non-option tenants?

A. Well, it shows that in the Homewood Tract there were five given for five months—or for a month-to-month period, that [24] is—and 58 were given for 12-month periods. And in Southwood all 89 were given for 12-month periods. And the Shoreview all, or 63, were given for 12-month periods.

Q. Mr. Moore, referring to Plaintiff's Exhibit 10, will you examine Plaintiff's Exhibit 10 and state to the Court how many leases you found on the house represented by that folder? Will you give the dates of the leases, please, too?

A. All right. Well, there are four leases. There is one dated October 1, 1942; another dated June 15, 1943; another dated February 6, 1944; and a fourth one dated August 1, 1944.

Q. Will you also state to the Court which of those leases, if any, contain an option in the tenant to purchase?

A. The first two leases contain an option to purchase.

The Court: We will take a recess.

(Whereupon a short recess was taken.) [25]

(Testimony of James E. Moore.)

Q. (By Mr. Wrixon): Mr. Moore, I will show you the exhibits attached to the stipulations numbered 5, 6 and 7; and I also show you Plaintiff's Exhibit 11 relating to number and types of leases.

Will you state to the Court from the exhibits which I hand you for each of the tracts, the Homewood, Southwood and Shoreview; the number of houses in each tract or number of leases in each tract that were executed, please?

A. In the Homewood Tract there were 212 houses and there were 419 leases given. In the Southwood Tract there were 72 homes and 89 leases given. In the Shoreview Tract there were 63 houses and 63 leases given.

Q. Well, will you explain to the Court the reason the number of leases exceeded the number of houses?

A. Well, the reason for that was that some of the houses were rented more than one time.

Q. Can you tell from your examination of the records of the leases, Mr. Moore, in which tracts there were leases with option in the tenants to purchase and in which tract or tracts there were executed leases without option in the tenant to purchase?

Mr. Blackstone: That has already been stipulated to. I think it just prolongs this. Your stipulation indicated the Homewood Tract had leases with option and the other two tracts did not. [26]

Mr. Wrixon: Except that I wish to bring out, your Honor, that in the Homewood Tract they had

(Testimony of James E. Moore.)

leases of both types, too. I will ask the question directly.

Q. (By Mr. Wrixon): In the Homewood Tract, in your examination of the leases with reference to the homes in that tract, did you find both types of leases?

Mr. Blackstone: Just a minute. I think that is going to be contrary to the stipulation unless you fix it as to time. As I understand the stipulation, the houses originally were all leased with option.

Mr. Wrixon: That is right.

Mr. Blackstone: And it appears also from the stipulation that after some of the leases with option expired you entered into another type of lease. I don't know what more this witness can say than what we have stipulated.

The Court: I think that covers it.

Mr. Wrixon: Very well. No further questions.

Cross-Examination

By Mr. Blackstone:

Q. Mr. Moore, turning first to Exhibit 6, which was prepared by you for the Southwood Tract, as I recall you testified that that information was prepared from information appearing in certain folders; is that correct? A. Yes.

Q. And that was introduced into evidence as Exhibit 8, a [27] folder which is a sample folder for that tract. Was that your testimony?

A. Yes, if that is the folder.

(Testimony of James E. Moore.)

Q. Would you look at that folder and tell the Court whether that shows if the sale was made to a tenant or to a non-tenant?

A. It is taking some time. I know the last tenant was a fellow by the name of Pearson. I am trying to determine the purchaser here.

No, the sale was made to a non-tenant.

Q. Does that folder show whether a commission was obtained upon the sale of this house to a non-tenant? A. Yes, it does.

Q. How much was the commission?

A. \$342.50.

Q. Do you recall from looking at the other folders relating to Southwood Tract if a commission was collected upon the sale of a house to a non-tenant?

A. I couldn't recall that it was in every instance. I do recall that there were some sold where a commission was given, but I could not be specific.

Q. Does the folder indicate who the broker was who handled the transaction?

A. Yes. It indicates a Mr. F. F. Brackett.

Q. Does it say what company he is with or where he is [28] located?

A. No, it doesn't seem to.

Q. In regard to the folders that you looked at where a sale was made to a tenant, was there any commission exacted, if you recall from the folder?

A. No. What I would be saying would be speculation.

Q. Well, if you don't remember, Mr. Moore, that

(Testimony of James E. Moore.)

is a satisfactory answer. I just want to know whether you remember in the folders on sales made to tenants whether a commission was charged on the sale?

A. No, I don't remember. However, it doesn't seem likely.

Q. I am just interested in your memory as to what you saw in the folder.

Turning to Exhibit 9, which I believe was a sample folder from which you compiled the statistics shown on Exhibit 7 for the Shoreview Tract, does that show whether the sale was made to a tenant or a non-tenant?

A. That sale was made to a tenant.

Q. To a tenant? In regard to these statistics shown on Exhibit 7 for the Shoreview Tract, you have indicated that seven houses were sold in the last three months of 1943. Would the folders on those houses indicate whether the houses had been rented prior to sale or not?

A. No, they did not indicate that.

Q. Were any leases included in those folders for the sales [29] of the first seven houses?

A. No.

Q. There were no lease forms at all, is that correct? A. Correct.

Q. You do not know of your own knowledge, however, apart from the folders, if they were sold to tenants or non-tenants? A. That's right.

Q. Referring now to Exhibit 10, which is one of the folders from which you compiled statistics

(Testimony of James E. Moore.)

for the Homewood Tract, Exhibit 5, does that exhibit show whether the sale there involved was made to a tenant or a non-tenant?

A. It shows a sale to a non-tenant.

Q. Does it indicate whether the house was vacant prior to the sale?

A. No, it is practically impossible to tell that from the file folder.

Q. Turning to Exhibit 5, which is the Homewood Tract, do you have a copy of that?

A. No, I don't.

Q. Column 1, you testified, were sales to tenants holding purchase options. I am not clear in my mind. Mr. Moore, in regard to the other sales shown in Columns 2, 3 and 4. Were those sales made to tenants or to non-tenants?

A. They could have been either. They could have been a sale to a tenant without an option or to a non-tenant. [30]

Q. But the exhibit as it is prepared does not indicate one way or the other whether the sale was made to a tenant or to a non-tenant, is that correct?

A. That is correct.

Q. In Column 3, it isn't clear to me, what the necessity for such a column is here in this breakdown. You have, "Sales made more than 30 months after last purchase option agreement executed, and not included in Columns 1 or 2."

A. Yes. Well, Column 2 made the point that the sales were made—the sales were made after the purchase option had terminated, then the new tenant had come in under a non-option lease.

(Testimony of James E. Moore.)

Column 3 makes the point that these sales were made more than 30 months after the option agreement had been signed, but indicates that the option had terminated or expired due to the running of time, and then the sale had been made—to whom, I really don't know.

Q. In other words, the Column 3 you put, it might have been made to a tenant holding a simple lease without an option, might have been made to a person who wasn't a tenant at all, might have been made to a person who held the original lease with option, but who was holding over after the option expired, and the folders do not indicate which?

A. Yes, after the option expired, we don't know whether the option holder stayed there or not. [31]

Q. That could be determined, couldn't it, from looking at the name of the purchaser from the file and comparing with the name of the prior lessee?

A. Yes. However, these seven sales in Column 3 were not made to the option holders.

Q. I understand. The option was expired. But it could be determined whether or not a sale was made to a person who had previously been a tenant?

A. Yes. However, if that were the case, it would be in Column 1.

Q. I thought Column 1 was all those holding an option which had not expired?

A. Well, that is true. And it was sales to tenants who held an option to purchase. [32]

CHARLES P. MABEY

was called as a witness on behalf of the Plaintiff, and being first duly sworn to tell the truth, the whole truth and nothing but the truth, testified as follows:

The Court: Your name, please?

The Witness: Charles P. Mabey.

The Court: Where do you live?

The Witness: San Carlos, California.

The Court: Your business or occupation?

The Witness: Public accountant.

The Court: How long have you been so engaged?

The Witness: Eighteen years.

The Court: Take the witness.

Direct Examination

By Mr. Wrixon:

Q. By whom are you employed, Mr. Mabey?

A. Lester, Herrick & Herrick, Certified Public Accountants.

Q. Have you been employed on the staff of Lester, Herrick & Herrick continuously since you joined them? A. Yes, sir. 1936.

Q. What has been the nature of your work, Mr. Mabey?

A. Well, I started with them as a Junior Accountant and I have been employed continuously. I now am engaged in auditing, preparation of tax returns, consultation, and so forth. [37]

Q. Have you had anything to do with the accounts of Pacific Homes, Inc.? A. Yes, sir.

(Testimony of Charles P. Mabey.)

Q. What was the nature of the first work done by you for Pacific Homes, Inc.?

A. Pacific Homes, Inc., contacted us in 1942, and when I was assigned to the case it was with the purpose of reviewing their accounts to see if they were adequate.

Q. Did you make any suggestion as to the records to be kept by them?

A. Well, at that time the construction of the subdivision known as Homewood had been completed, and I found that the accounting in that connection was all right, but that there were certain matters of importance that needed attention.

Since the houses had been completed and rented—that is, partially, or not completely rented—I do not recall, but the matter of year's depreciation was important, which I did. There was the matter of rentals coming in and some kind of control was required there.

Then, payments were being made to the bank on FHA. Some type of control was needed there, and particularly as it relates to the reserve fund portion of the FHA payment. I guess that was the urgent items at that time.

Q. Did you suggest the installation of any particular records by Pacific Homes? [38]

A. The extent of their accounting actually I do not recall, particularly as to what they had already done beyond that of the construction; but we did give attention to the thing that was important,

(Testimony of Charles P. Mabey.)

which was operation accounts of the subdivision, and I provided them with a rent record which combined also the features of payments made on FHA to the bank, showing how much would be interest, how much would be principal, how much of it went into the reserve fund for insurance and taxes.

Other records that I gave was a list form that would show the individual cost of the homes and depreciation to be accounted.

Q. Did the company keep the records which you have suggested by tracts? A. Yes, sir.

Q. Did you have any idea how the preparation—rather, did you have anything to do with the preparation of the Federal income and excess profits tax returns of the Pacific Homes, Inc.?

A. Yes, sir; I prepared them.

Q. Did you prepare all of such returns that were filed by the plaintiff? A. Yes, sir.

Q. In connection with the preparation of such returns, did you examine the accounts to determine what data should go [39] into the returns?

A. I didn't hear the last part.

Mr. Wrixon: Would you repeat it, Mr. Reporter?

(Question read by the Reporter.)

The Witness: Yes, sir.

Q. (By Mr. Wrixon): Now, were the expenses concerned with the facts kept separate as well as the income from the rents on each of the tracts?

A. Yes, sir. That is, as to the direct expenses.

Q. I will refer you, Mr. Mabey, to Exhibit 2

(Testimony of Charles P. Mabey.)

attached to the stipulation, the exhibit being designated as "Rents Received From the Organization to the Liquidation of the Company," and I will ask you, did you prepare Exhibit 2? A. Yes, sir.

Q. And will you state to the Court—will you explain to the Court, rather, the figures on Exhibit 2?

A. The exhibit is broken down as between the tracts of Pacific Homes, Inc., and it shows gross rentals by taxable years and the expenses and the net rental for each of those tracts of Homewood, Southwood, Shoreview, Westwood, Bayshore Park, Morey Tract, and then totaled.

Q. Now, the figures at the bottom of the statement, the net rental income in the amount of \$89,799.08, will you state whether that net rental income includes any pro rata of the administrative expenses? [40]

A. No, it does not. Each subdivision had its tract office, and so the expenses that went into this schedule and also on the books of the corporation would be the expenses that arose in connection with the operation of that tract office as opposed to administrative expenses that would arise in the general office of the company.

Q. Well, now, what is the general nature of the expenses which are included within that caption, "Administrative Expenses"?

A. Well, for certain years, not all of them, depending on the business that the company was doing, there was an allocation of officers' salary, there were items like general office rent, depreciation on the office equipment, donations, any business promotion,

(Testimony of Charles P. Mabey.)

and the general office stationery, printing and office expense.

Q. Well, will you just explain to the Court why they were grouped under the heading "Administrative Expenses" instead of being allocated to the different tracts?

A. Well, we—it would have been rather difficult for that type of expense, for example your donations, office expense, to make a proper allocation between the tracts and also as between what would be rental, operation, and what wouldn't.

Aside from the operation of the tract itself, so far as accounting goes, and the general office help, salaries, [41] and so forth, there was the matter of owing the FHA payments, and there was new business promotion, which had nothing to do with rental operation.

Q. What is the effect, from an accounting standpoint, of failing to allocate any portion of the \$152,884.88 in administrative expenses to the various tract income?

A. Well, the net effect would be that you would throw more expense against the tract operation, and consequently reduce the net rental income by whatever amount had been allocated.

Q. Do you mean that if you would allocate some portion of the \$152,884.88 to various tracts it would reduce the net income shown for each tract on Exhibit 2? A. Yes.

Q. Now, will you refer, please, to the fourth tract that shown on Exhibit 2, the Westwood Tract?

(Testimony of Charles P. Mabey.)

Will you state whether the houses in the Westwood Tract were originally owned by the plaintiff?

A. Originally, no, they were not owned by the plaintiff.

Q. What company, if you know, did own the houses in the Westwood Tract?

Mr. Blackstone: We stipulated it was purchased by Western Homes, Mr. Wrixon. I don't understand why we need go into this again.

Mr. Wrixon: Very well. I thought it was appropriate [42] to mention to the Court that there were some of these tracts, your Honor, which did not originate with the plaintiff in this case, but were some houses taken over by the plaintiff in order to liquidate the capital account of the other corporation which is also involved, Western Homes, Inc.

The Court: It is covered in the stipulation?

Mr. Wrixon: I think it is. Perhaps not in quite as much detail as I was going to ask, but I think substantially.

Q. (By Mr. Wrixon): Referring to the sixth tract listed on the statement, Mr. Mabey, the Morey Tract, how many homes were involved in this tract?

A. Forty.

Q. And will you explain why the rentals and expenses for this tract appear in only one column, that is, in the Fiscal Year ended May 31st, 1946?

A. Well, the ownership fell within all that one year, the houses being completed and rented and sold during that one fiscal year.

Q. Well, how were the proceeds from the sales

(Testimony of Charles P. Mabey.)
of the houses in the Morey Tract treated on the plaintiff's income tax return?

A. As a short-term capital gain—capital loss, excuse me, the Morey is.

Q. Morey?

A. That would be on the short-term gain. [43]

I think I'd better correct myself, your Honor. It is pretty difficult to keep these straight. The Morey Tract was a loss operation and would have been a short-term—

Mr. Blackstone: Just a minute. I move that be stricken. That is his conclusion. I don't object to his stating what was put on the return, but I certainly object to what the witness' conclusion, and if it is important, it is for your Honor to decide.

The Court: Is that a legal conclusion, if you know?

The Witness: On the return that was put that way, your Honor.

The Court: The objection will have to be sustained. You may develop it.

Q. (By Mr. Wrixon): In what manner was the results of the sale of the Morey houses shown on the income tax return of the plaintiff, if you recall?

A. What was the result?

Mr. Wrixon: Would you read the question, Mr. Reporter?

(Question read by the Reporter.)

The Witness: I am sorry, I don't understand the question.

(Testimony of Charles P. Mabey.)

Mr. Blackstone: I will stipulate that it is shown on the return, in the way we agreed it was reported, as a short-term capital loss on the tax return. Sales from the Morey Tract. There isn't any dispute about how they reported [44] it.

The Court: It is twelve o'clock. We will take a recess until two o'clock.

(Whereupon this cause was recessed until the hour of two o'clock p.m., this date.) [44-A]

Monday, December 13, 1954—2:00 P.M.

(Whereupon, following the noon adjournment, the witness Charles P. Mabey resumed the stand and testified further on direct examination by Mr. Wrixon as follows.)

Mr. Wrixon: If your Honor please, there is a matter mentioned in the stipulation in Paragraph 14 concerning the length of time the houses sold in the years 1945, 1946 and 1947 were held by the plaintiff. This question might be a little duplication, but I would like to ask it to clear up a point that isn't entirely clear in the stipulation.

The Court: Very well, proceed.

Q. (By Mr. Wrixon): Mr. Mabey, referring to the sales of houses made by the plaintiff out of the Homewood, Shoreview and Southwood Tracts, during the years, fiscal years, May 31st, 1945; May 31st, 1946, and May 31st, 1947, can you state whether all those sales of houses are represented by sales of houses owned for more or less than six months?

(Testimony of Charles P. Mabey.)

A. They were held more than six months.

Q. Can you state how they were reported on the income tax returns of the plaintiff?

A. As sales of long-term capital assets.

Mr. Wrixon: Now, if your Honor please, may I state for the record that Plaintiff's Exhibit 18, which is in evidence, [45] includes in addition to Form 1120, United States Corporation Income and Declared Value Excess Profits Tax Return, also attached as part of the exhibit Form 1121, Corporation Excess Profits Tax Return for the same fiscal period; that is, the period ending May 31st, 1945.

Q. (By Mr. Wrixon): Mr. Mabey, I will show you Plaintiff's Exhibits 18, 19 and 20, being the Federal income tax returns for the three years here involved; and I will ask you to look at them and state to the Court the place on those returns in which the rents and the rental expenses were reported.

A. They are on lines 4 and 5, "Gross Receipts (where inventories are not an income-determining factor)," and "Less cost of operations."

Q. And were the items of rental income and rental expense reported on the same lines of the income tax returns for each of the years ended May 31, 1945; May 31, 1946, and May 31, 1947?

A. Yes, they were.

Q. Now, will you state to the Court whether the income tax returns, Forms 1120, for each of the years here involved contains a line 10 upon which you report a certain item?

(Testimony of Charles P. Mabey.)

A. Line 10 is indicated as "Rents."

Q. Is that true on the income tax return forms for each of the years May 31, 1945; May 31, 1946, and May 31, 1947? [46] A. Yes, sir.

Q. Were any of the amounts of rental income or rental expense applicable to the plaintiff for one or more of the fiscal years here involved reported on line 10? A. No, sir.

Q. Well, will you state to the Court why items of rental income and expense were reported as you have testified, rather than reporting them on line 10?

A. Well, you look at the tax return, you know that you have rentals that must be reported, and just going down the tax return as to matters of income, we have on line 1, "Gross Sales (where inventories are an income-determining factor)," and it wouldn't seem as though the rentals would properly go in that space.

Then you look at line 4, "Gross Receipts (where inventories are not an income-determining factor)." We had the rentals, we had the offsetting expenses incident thereto, and since it would appear that that was the type of business that the company was in, the lines 4 and 5 would be the logical place to put them as opposed to, let's say, line 10, where I would look at it as being where an item of rent should go other than the type with which we are concerned.

Q. Well, I call your attention, Mr. Mabey, to Plaintiff's Exhibits 18, 19 and 20; and particularly to a number, "182," appearing opposite a title:

(Testimony of Charles P. Mabey.)

"Business Group Serial Number [47] (From Instruction N)." Will you explain to the Court the significance of No. 182?

A. Well, it is a number furnished by the—that is, the Code indicates by numbers certain types of businesses, and the person preparing the return is asked to indicate by that number the business that the taxpayer is in.

Q. And can you—excuse me, your Honor.

The Court: What business is he in?

The Witness: As to the matter of the tax return, your Honor, why, the number 182 would indicate they were operators and owners of improved real estate. That would be a number that you could select from in the instructions with the tax return itself.

The Court: Under what section?

The Witness: You mean the Code number?

The Court: Code number.

The Witness: I don't know that, your Honor. It is just an instruction sheet that comes with the tax return.

The Court: Proceed.

Q. (By Mr. Wrixon): Mr. Mabey, I will show you a form entitled "Instructions for Form 1120, United States Corporation Income Tax Return, 1946," and I will ask you to examine the document which I hand you and state to the Court whether you have ever seen such a document before.

A. Yes, sir. They come each year with the blank form of [48] return sent out by the Bureau.

(Testimony of Charles P. Mabey.)

Q. And does the form which I have just handed you indicate the numbers that are used to designate the business in which the company is engaged?

A. Yes, sir.

Q. Is that the instruction sheet from which you selected the number 182 which you placed on the return? A. Yes, sir.

Q. And is there a corresponding sheet for each year which you examined in preparing the income tax returns of the plaintiff?

A. Yes, there would have been.

Q. And were the instruction sheets for corresponding years the same as the one which you have in your hand? A. Yes, sir.

Q. And in each case the number 182 indicated the same description of the type of business as has been testified to by you, is that correct?

A. It appears on each of these returns.

Mr. Wrixon: I offer in evidence, if your Honor please, "Instructions for Form 1120, United States Corporation Income Tax Return" for the year 1946.

The Court: Let it be admitted next in order.

(Whereupon document referred to above was received in evidence and marked Plaintiff's [49] Exhibit No. 22.)

(Testimony of Charles P. Mabey.)

PLAINTIFF'S EXHIBIT No. 22

Page 1
1946

Instructions for Form 1120

United States Corporation Income Tax Return

(References are to the Internal Revenue Code,
unless otherwise noted)

General Instructions

A. Corporations which must make a return on Form 1120.—Every domestic and every resident foreign corporation not specifically exempted by section 101, whether or not having any net income, must file a return. The term "corporation" is defined by the Code to include associations, joint-stock companies, and insurance companies.

Receivers, trustees in dissolution, trustees in bankruptcy, and assignees, operating the property or business of corporations, must make returns of income for such corporations. If a receiver has full custody of and control over the business or property of a corporation, he shall be deemed to be operating such business or property, whether he is engaged in carrying on the business for which the corporation was organized or only in marshaling, selling, and disposing of its assets for purposes of liquidation.

B. Period to be covered by return.—Returns shall be filed for the calendar year 1946 or fiscal year beginning in 1946 and ending in 1947. A fiscal

(Testimony of Charles P. Mabey.)

year is an accounting period of 12 months ending on the last day of a calendar month other than December.

* * *

182. Owner-operators of improved property and lessors of buildings.

183. Owners for improvement.

184. Trading for own account.

185. Agents, brokers, managers, etc.

186. Title abstract companies.

187. Lessee operators of improved property.

* * *

Filed December 13, 1954.

Q. (By Mr. Wrixon): Now, are you able to tell from the plaintiff's records on which tracts houses were constructed by the plaintiff as compared with tracts on which houses were built by others and sold to the plaintiff? A. Yes, sir.

Q. Will you state to the Court what the records indicate in that respect so far as the Homewood Tract is concerned?

A. The Homewood Tract was improved by Pacific Homes.

Mr. Blackstone: May it please the Court, all this matter is stipulated to. What is the point of the question?

Mr. Wrixon: Merely to establish, Counsel, that the plaintiff itself constructed the homes in Home-

(Testimony of Charles P. Mabey.)

wood, and that is consistent with the application for—application to obtain the priorities; and it also explains the exhibit in the priority list which states that the houses were built for sale. It is merely to establish some of the houses were built and some were not built directly by the company.

Mr. Blackstone: Which ones are they, Mr. Wrixon?

Mr. Wrixon: The witness will testify, I think, that the houses in Shoreview and Southwood were not constructed by the plaintiff, but were acquired by the plaintiff from another builder upon completion.

Mr. Blackstone: All right, can't we stipulate to that? You never requested us to stipulate to that. I suppose it is a [50] fact. Go ahead. I am sorry to interrupt.

Q. (By Mr. Wrixon): Will you state to the Court what the records of the plaintiff show so far as the acquisition by the plaintiff of houses in the Shoreview Tract and Southwood Tract are concerned?

A. Well, they did not do the improvement and construction themselves on Shoreview and Southwood.

Q. Did the plaintiff purchase the houses from someone else who built them? A. Yes, sir.

Q. Will you state to the Court whether the records were maintained in such form as to indicate separately the rentals and expenses connected with the rental collections as compared with the sales of houses?

(Testimony of Charles P. Mabey.)

A. They were all kept separately.

Q. And what records were maintained in connection with each type of receipts?

A. Well, of course there was the general ledger account for rentals maintained separately as to the tracts. Then there were general ledger records for the sale of each home, also by tracts. Then there were underlying subsidiary records in connection with the sale of houses to show the transaction as it related to each individual house.

Mr. Wrixon: I believe that is all. [51]

Cross-Examination

By Mr. Blackstone:

Q. Mr. Mabey, directing your attention to Exhibit 2, which is entitled "Rents Received," and breaks down the rents received from the various tracts for the various fiscal years from 1943 through their fiscal year 1947, as I understand it, you were the one that prepared this schedule, is that correct?

A. Yes, sir.

Q. At the bottom of the schedule appears "Net Rental Income." Yet it appears, also, that you have not deducted from the net rental income any share of the administrative expenses, is that correct?

A. That's correct.

Q. Well, as an accountant, do you think that that is an accurate picture of net rental income to

(Testimony of Charles P. Mabey.)

report a figure which does not include the overhead expense?

A. Well, it would—could be deducted this way: Where you have these tracts involved, and where you have the company engaged in activities other than these tracts, or likely to have, it would seem to me it would give the management more information if they allocate the direct expenses of each tract, that is, the salary, let's say, of a tract manager.

Let me explain, perhaps: If that is expressed with relation to each tract for tract manager's salary, there is the interest that was paid on the FHA loan, there are the real [52] estate taxes on the loan, depreciation, the general office expenses of the tract, you have with that information which you know is definite, you have a more accurate figure to rely on than if you try to take these administrative expenses that, as the system is developed, applied to matters other than rentals. The allocation might bring into close relationship, but who is to say the allocation would be correct when there are other activities?

Q. Let me ask you this question: I am not an accountant, Mr. Mabey, but if a company is engaged solely in the business of renting houses in question, as an accountant, in figuring its net rental income, would you present a document which did not deduct from that its administrative expenses?

A. I can agree that seeing administrative expenses would be interesting, and probably try to find out if that administrative expense could be allocated as it would be more—

(Testimony of Charles P. Mabey.)

Q. What would there be to allocate among if you have a company engaged only in the business of renting property?

A. Well, as subsequent—in the first year—

Q. I think you could answer that question, Mr. Mabey.

A. I would like to explain with respect to this statement here, if I may.

Q. I am trying to get at that, but I think you could answer a question that was put to you directly. If you have a business which is engaged solely in the rental business, isn't [53] the correct way to find out the net income from the business and deduct all expenses, overhead as well as the direct expenses?

A. That would be proper.

Q. That would be correct? A. Yes.

Q. But you say in this case that you could not deduct part of the expenses that should be attributed to rental income because there were other operations the business was carrying on, is that correct?

A. In this respect: For example, the accounting attention that would be required to service FHA loans and so forth, do you feel that that should be charged against rental operations? That is one thing that would make allocation difficult. And a large part of whatever would be involved in payment of monthly FHA loans on all these houses, just as an item for example.

Q. Isn't the reason, Mr. Mabey, you didn't show allocations between administrative expenses to rental

(Testimony of Charles P. Mabey.)

income is because the company was also engaged in the business of selling houses?

A. Let's take this schedule. Well, it wouldn't show on this rent received schedule, but one of these sub-sections. Naturally when houses appear in this schedule as having been sold, some of that overhead expense, if you wish to throw it back, some would have to go against rental, some would have to go against [54] that other property.

Q. The other operation we are dealing with here is a selling operation, is it not? Look at Exhibit 3.

A. On Exhibit 3, you readily see you have a rental operation. You have some of this general expense that must apply against the houses sold, also. Yes, very definitely.

Q. And the reason why you did not allocate the administrative expense is because this company was engaged not only in a rental operation, but in a selling operation, is that not a plain fact?

A. In that regard, that very definitely—See that first one, now, I wouldn't know how much of this administrative expense should go against rental, how much should go against sales, or how much would apply to something else, that is true.

Q. Directing your attention, Mr Mabey, to the tax returns that have been introduced in evidence—I believe they are Exhibits 18, 19 and 20—did you prepare the entire return, including the caption? I notice here under "Kind of Business" in Exhibit

(Testimony of Charles P. Mabey.)

Q. it says, "Development of Subdivision, Renting and Selling Homes to Defense Workers."

A. Is that your language on the return?

A. I think so. I think my signature would be on the tax return, and anything that I didn't have in my own handwriting at least would be my responsibility.

Q. Well, at the time you prepared this, I assume you considered [55] that was an accurate description of what business the corporation was engaged in, is that correct?

A. I think so, if I put it there.

Q. I find that on Exhibit 19, the tax return for the year ending May 31st, 1946, the kind of business is given as, "Development of Subdivision, Renting and Selling Homes."

Here again I find your signature on the tax return, and I take it that is your language that you used in describing the business of the corporation?

A. I would say so.

Q. And Exhibit 20, which is the tax return for the year ending May 31st, 1947, under "Kind of Business," I find there appears "Development of Subdivision, Renting and Selling Homes." That is again yours? A. That sounds like me, yes.

Q. Mr. Mabey, I should like to show you a certified photostatic copy of an income tax return for this corporation for the period ending May 31st, 1942. Do you recognize this as having been prepared by you for this corporation?

(Testimony of Charles P. Mabey.)

A. Yes, sir, I am sure it is mine. It has my signature on it.

Mr. Blackstone: I should like to introduce in evidence as Defendant's Exhibit A this document.

The Court: For what purpose?

Mr. Blackstone: I should like to establish that in 1942 [56] the corporation represented its business as that of construction and sale of defense homes, which I think bears on the issue of what kind of business this corporation was in.

The Court: It will be admitted and marked for the limited purpose of the offer.

(Whereupon income tax return for period ending May 31st, 1942, was received in evidence and marked Defendant's Exhibit No. A.)

Form 1120
Treasury Department
Internal Revenue Service

UNITED STATES
CORPORATION INCOME AND DECLARED VALUE EXCESS-PROFITS TAX RETURN 1941

For Calendar Year 1941

or fiscal year beginning June 1, 1941, and ending May 31, 1942

PRINT PLAINLY CORPORATION'S NAME AND ADDRESS

PACIFIC HOMES, INC.
(Name)

859 SAN MATEO DRIVE
(Street and number)

SAN MATEO, SAN MATEO, CALIFORNIA
(City)
(State)

Kind of business: Construction & Sale of Defense Homes

District _____
(Cashier's stamp)

Serial No. 211179
File Code 1095-

\$

Business group serial number (from Instruction N) 193 and 182

NORMAL-TAX NET INCOME COMPUTATION

GROSS INCOME

Less: Returns and allowances \$ _____

\$ _____

Cash **Check** **M. O.**

(First Payment)

\$ _____

\$ _____

\$ _____

\$ _____

\$ _____

\$ _____

\$ _____

\$ _____

\$ _____

\$ _____

Instruction No.

1. Gross sales (where inventories are an income-determining factor) \$ _____

2. Less: Cost of goods sold. (From Schedule A) _____

3. Gross profit from sales _____

4. Gross receipts (where inventories are not an income-determining factor) \$ _____

5. Less: Cost of operations. (From Schedule B) _____

6. Gross profit (where inventories are not an income-determining factor) _____

7. Interest on loans, notes, mortgages, bonds, bank deposits, etc. _____

104



Q. (By Mr. Blackstone): Mr. Mabey, I show you—I should like you to identify a certified copy of the corporation's return for the year ending May 31st, 1943, for Pacific Homes, Inc., and ask you if you prepared that return?

A. Yes, sir, I can identify that as mine.

Mr. Blackstone: Thank you. I offer this in evidence as Defendant's Exhibit B for the purpose of showing that for the year ending May 31st, 1943, the corporation described its business as "Construction and Sale of Defense Homes."

The Court: It will be admitted and marked.

(Whereupon document referred to above was received in evidence and marked Defendant's Exhibit B.)

Filed December 13, 1954.

Form 1120
Treasury Department
Internal Revenue Service

UNITED STATES

CORPORATION INCOME AND DECLARED VALUE EXCESS-PROFITS TAX REFUND 1942

For Calendar Year 1942

or fiscal year beginning June 1, 1942, and ending May 31, 1943

PRINT PLAINLY CORPORATION'S NAME AND ADDRESS

A U C

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PACIFIC HOMES INC.
(Name)

859 San Mateo Drive
(Street and number)

San Mateo, San Mateo, California
(City)
(State)

Kind of business: Construction and Sale of Defense Homes

District _____
(Cabinets stamp)

Serial No. _____

File Code 565
Serial No. _____

Cash Check M. O.
First Payment

Business group serial number (from Instruction N) 193 and 182

\$ 777

NORMAL-TAX NET INCOME COMPUTATION

Item and
Instruction No.

1. Gross sales (where inventories are an income-determining factor) \$ 4,506.23; Less: Returns and allowances \$ 4,566.23
2. Less: Cost of goods sold. (From Schedule A) 1,434.39
3. Gross profit from sales 1,241.84
4. Gross receipts (where inventories are not an income-determining factor) \$ 83,470.50
5. Less: Cost of operations. (From Schedule B) 69,233.27
6. Gross profit where inventories are not an income-determining factor 14,237.22
7. Interest on loans made available to corporation at _____

GROSS INCOME

ITEM	AMOUNT
1. Gross sales (where inventories are an income-determining factor)	\$ 4,506.23
2. Less: Cost of goods sold. (From Schedule A)	1,434.39
3. Gross profit from sales	1,241.84
4. Gross receipts (where inventories are not an income-determining factor)	\$ 83,470.50
5. Less: Cost of operations. (From Schedule B)	69,233.27
6. Gross profit where inventories are not an income-determining factor	14,237.22
7. Interest on loans made available to corporation at _____	1104.17

(Testimony of Charles P. Mabey.)

Q. (By Mr. Blackstone): Now, Mr. Mabey, I ask you to look at the tax return for the year ending May 31st, 1944, for Pacific Homes, and ask you if you prepared that return. [57]

A. Yes, sir.

Mr. Blackstone: May I ask that this be admitted into evidence as Defendant's Exhibit C.

The Court: It will be admitted next in order.

Mr. Blackstone: The purpose being that it states on the face of the return, "Kind of Business: Development of Subdivision, Renting and Selling Homes to Defense Workers."

(Whereupon document referred to above was received in evidence and marked Defendant's Exhibit C.)



Q. (By Mr. Blackstone): Returning now, Mr. Mabey, to this Exhibit 2, the analysis of rents received, you would agree, I take it, that the net rental income figure there is then definitely overstated if one were interested in finding out what the actual, true net rental income of the corporation is after deducting whatever share of administrative expenses is proper?

A. Yes, I think that is accurately stated.

Q. And likewise on Exhibit 3, you would say that the profit on the sales shown there is likewise overstated because from an accounting point of view, certainly some of the amount of administrative expense not attributable to rental received should be accounted to the selling of the property, is it not?

A. That was my purpose for putting the note there at the bottom. [58]

Q. In other words, you yourself did not feel you had enough information to decide in what way the allocation of administrative expense should be made, is that correct? A. That is right.

Q. But you did recognize, certainly, some of it should be attributable to rental operations and some of it should be attributable to selling operations, is that correct? A. Yes, sir.

Q. Turning to Exhibit 4, Mr. Mabey, which is entitled "Investment in Real Property and Notes and Mortgages Payable," I take it you prepared that exhibit also? A. Yes, sir.

Q. Is it possible for you as an accountant to decide from looking at these exhibits here, Exhibit 4,

(Testimony of Charles P. Mabey.)

which is the investment in the real property, and Exhibit 2, which is the profit from the real property—or which is the rental analysis—to decide what the return on the investment was insofar as rental operations were concerned? By that I would mean what accountants I suppose would call the yield on investments.

A. It seemed to be quite clear that the percentage would be fairly low. Did you want me to try to state what that per cent would be?

Q. Yes, and if you could explain. I would take it in figuring the percentage you would not, for example, starting with the [59] first period ending May 31, 1942, Exhibit 4 shows there is something a little over \$225,000 invested in improved property; Exhibit 2 would indicate a net rental income of \$14,000, but to which you would apply some formula for administrative expense?

A. They are different years. There is no May 31st, 1942, on the first schedule.

Q. I see. Then the first one you could make an analysis on would be for the year ending May 31st, 1943, is that correct? A. That is correct.

Q. And would you explain how one would attempt to figure out the yield on the investment, looking solely from rental income point of view for that year?

A. Well, as I get the question, it would look like 2 per cent plus.

The Court: I can't follow that. What do you mean by that?

(Testimony of Charles P. Mabey.)

The Witness: Well, your Honor, the investment is \$644,000, and the net rental income for that year was \$14,000, so the fourteen thousand would be 2 per cent something, wouldn't it?

Q. (By Mr. Blackstone): And that is, however, figuring without attributing to the rental income any share of the administrative expense, is that correct?

A. Yes. [60]

Q. I see that the administrative expense total for that year was \$16,000. So that if this company had been doing nothing but a rental business, they would have lost money for that year, isn't that correct?

A. Yes.

Q. And there would then, of course, be no return whatsoever on the investment for that year?

A. That is right.

Q. For the year ending May 31st, 1944, could you give an estimate of what the yield would be without taking into account the pro rata share of administrative expenses?

A. Well, it looks like it would probably run about two and one-half per cent.

Q. But I see for that year there are \$15,000 or more in administrative expenses, so that if all of that were attributed to rental income, that would approximately reduce by half the yield you stated, is that correct?

A. Yes, sir.

Q. It would be a little over one per cent, then?

A. That's right.

Q. For the year ending May 31st, 1945, Exhibit 4 indicates \$996,000 plus as the investment, and Ex-

(Testimony of Charles P. Mabey.)

hibit 2 indicates a net rental income of \$33,000. Roughly speaking, what would that yield be?

A. Well, that one would run three per cent or better. [61]

Q. But then, directing your attention to the administrative expenses that were not allocated of \$20,000, if that were attributable to rental income, what would the yield on the investment be, approximately?

A. Oh, one and one-half per cent, one and three-tenths, somewhere around there.

Q. And for the year ending May 31, 1946, Exhibit 4 indicates something over \$263,000 invested, and Exhibit 2 indicates a net rental income of \$12,936. Now, what would you estimate the yield would be from those figures?

A. Looks like it would run six per cent.

Q. I see for that year, 1946, their administrative expenses of \$58,000 which, if all were attributable to rental income, would wipe out any income whatsoever for that year, would it not?

A. Yes, sir.

Q. Which would mean there would be absolutely no yield whatsoever on the investment of \$263,000 for that year, is that correct?

A. That is correct?

Q. Do you as an accountant know or have some opinion as to what the yield should be on rental property, what a landlord ordinarily expects to earn on money invested in his real property?

A. I haven't gone into that as an accountant.

(Testimony of Charles P. Mabey.)

particularly, or [62] in connection with my work. But as speaking of a return on any investment, I guess the risk element is involved. But aside from all of that, five or six per cent, anyway, would seem to be a figure that anyone should look for.

Q. Have you ever heard of a formula used by landlords of receiving in rent approximately one per cent per month of the amount invested in real property?

A. Oh, I couldn't really answer that.

Q. Mr. Mabey, I am interested in your testimony in regard to those sales from this Morey Tract, so-called, which occurred in the fiscal year ending May 31st, 1946. That sale of those houses resulted in a loss of \$9,561, is that correct? It appears here on Exhibit 3. A. Yes, sir.

Q. Could you explain the reason for your reporting that on the income tax return as a short-term capital loss?

A. The fact that the houses were held for a period less than six months.

Q. You did not consider that these houses were houses used in the trade or business of the Pacific Homes Company?

A. Well, I think in effect the over-all treatment or determination that the same basis was used, that is, the only determination being whether the house was held over six months or less than six months, both as to the Morey Tract and the other subdivisions. [62-A]

Q. Well, may I put it this way: May I ask you

(Testimony of Charles P. Mabey.)

upon what information you were relying to treat these sales after a period of six months as sales of capital assets or assets held for investment?

A. What basis I was using?

Q. Yes. What facts did you have? What information did you have which caused you to treat the sales in this way?

A. Well, the fact that they were—the houses were subject to depreciation, and the fact that they were not—at least I did not consider them as being part of the company's inventory on the basis—or, in other words, if they had been inventoriable items, that would mean they were considered primarily for sale, which was not the interpretation that I used in the preparation of the tax returns.

Q. Well, what information did you have that these houses were not held for sale? The fact is they were all sold within a six months period, isn't that correct?

A. On the Morey Tract?

Q. Yes, on the Morey Tract. A. Yes.

Q. We are talking about the Morey Tract.

A. Yes, sir. To me in preparation of tax returns, the fact that they were held less than six months, the whole question was just academic in that it didn't enter into the capital gain, tax capital gain computation for the other houses. [63]

Q. Well, can I interpret that then to mean that you didn't really make any specific inquiry of anyone in the corporation as to the exact nature of their business relating to the houses, that you felt it didn't really make any difference whether it was

(Testimony of Charles P. Mabey.)

reported as a short-term capital loss or as an ordinary business loss?

A. To me the—as I remember the Code there, the short-term loss acts as a reduction of the long-term gain in the computation and didn't affect the tax picture at all. So, so far as I was concerned, my questions would be answered in connection with the preparation of the return.

Now, as to what the intention was with regard to these Morey houses, I would have no more information than what the management perhaps would have told me at the time. Whether or not I put any question to them, I do not recall.

But in answering your question now, I don't think that it would have made any difference in the preparation of the tax return whether they said it had been held primarily for sale or for rent. The treatment still would have been the same.

Q. If these houses, then—your understanding of the tax laws would be that if these houses were used in the trade or business of Pacific Homes, Inc., that it was then proper to treat a sale of them, when it results in a loss, as a short-term capital loss. [64]

A. If it is used in the trade or business?

The Court: Is that the question?

Mr. Blackstone: Yes.

The Witness: I didn't get the full significance in order to answer the question. I am sorry.

Q. (By Mr. Blackstone): Well, was your understanding of the tax law that it is a proper tax treatment to report as a short-term capital loss a

(Testimony of Charles P. Mabey.)

sale of property used in the trade or business which resulted in a loss.

A. To treat it—give it the capital gains and loss treatment, yes, sir.

* * *

ROSS H. CHAMBERLAIN

was called as a witness on behalf of the plaintiff, and being first duly sworn to tell the truth, the whole truth and nothing but the truth, testified as follows:

The Court: State your name, please.

The Witness: Ross H. Chamberlain.

The Court: Where do you reside?

The Witness: Woodside. [65]

The Court: Your business or occupation?

The Witness: I am a contractor.

The Court: How long have you been so engaged?

The Witness: 17 years.

The Court: Take the witness.

Mr. Wrixon: If your Honor please, it is in the stipulation that the witness was one of the three incorporators of the plaintiff corporation, and that he was a director of the plaintiff corporation from the inception until the dissolution and winding up of the corporation; that he was secretary and treasurer from January 30, 1942, up until January 4, 1945; that from January 4, 1945, until the dissolution of the corporation the witness was president of the plaintiff.

It is also in evidence that he was one of the two shareholders during the entire existence of the

(Testimony of Ross H. Chamberlain.)

corporation, and from and after May, 1945, the witness was the sole shareholder of the plaintiff.

I say that merely to indicate that I will dispense with the usual questions laying foundation for what I am about to ask him.

Direct Examination

By Mr. Wrixon:

Q. Mr. Chamberlain, did you take any part in the management of the affairs of the Pacific Homes, Inc.? [66] A. Yes, sir.

Q. And over what period did you participate in the management of the plaintiff's business?

A. From its inception to its dissolution.

Q. And what was the nature of your services to the plaintiff over that period of time?

A. I was officially secretary and treasurer, and I generally managed its activities prior to the renting of the houses, and I participated in financial decisions and things like that.

Q. Well, did you take any part in determining whether the plaintiff would engage in the building of houses in a certain tract or not? A. Yes.

Q. What investigation, if any, was made on behalf of the plaintiff before deciding to construct or acquire houses in a certain tract?

A. Well—

The Court: Speak up louder.

The Witness: Pardon me?

(Testimony of Ross H. Chamberlain.)

The Court: Raise your voice to help the Reporter.

The Witness: Do you want the whole story?

Q. (By Mr. Wrixon): Yes. Tell it completely, sir.

A. These houses were built during the period of the War, and at that time the only construction that could be legally [67] undertaken was construction which had priority assistance.

The priority assistance was given the construction industry in general regardless of whether the projects were private or for the account of the Government by the Office of Production Management, which was the prototype of controlling organization, or later the War Production Board, which was the successor to the Office of Production Management.

The first tract that I participated in on a priority basis was the Homewood Tract in Sunnyvale. The initial impetus to construct that tract and all of the others came from this Federal office, first the OPM and secondly the WPB, who got in touch with qualified developers and suggested that accommodations for war workers in certain areas were necessary.

When we were approached on the subject of building houses in Sunnyvale, we went to Sunnyvale and discussed the employment situation and the housing situation with employers in the neighborhood, who were largely of Joshua Hendy Ironworks and Woolridge Company, and we established to our

(Testimony of Ross H. Chamberlain.)

own satisfaction that there was a demand for dwelling houses in the area, and then we looked around to see where a suitable land was available to build them on.

Then when that was determined, we went to the War Production Board, or OPM, as the case may be, and told them if they would grant us priority assistance for a certain [68] number of houses, we would be happy to build them.

Q. And was that procedure which you have just described followed not only in the case of Homewood but in the other tracts as well?

A. I would say that it was typical.

Q. And in considering whether you would build in a certain tract, did you give any consideration to the prospective rents and the prospective expenses that would be involved in the operation?

A. Well, we knew what the rent was going to be because that was fixed by law. And we knew what the expenses were going to be insofar as they related to the mortgage because the amount of the mortgage was also fixed by law.

And the answer to your question is that if the rent, for instance, was \$50 a month and the amount that had to be repaid on the note was \$40 a month, there was a theoretical gross profit of \$10 per month per unit.

Q. Well, now, calling your attention, Mr. Chamberlain, to the Southwood Tract, what did the Pacific Homes, Inc., intend to do with the Southwood Tract when it was completed?

(Testimony of Ross H. Chamberlain.)

Mr. Blackstone: I object to his asking about the intention of the Corporation.

Mr. Wrixon: If your Honor please, I submit that is one of the questions which is involved in the case. And I have some authorities here that indicate where the matter of intent [69] is the issue in the case, the witness is competent to testify to the intention.

Mr. Blackstone: That may be, your Honor, if you are dealing with an individual. An individual could testify as to his own intent. But we are dealing with a corporation, which necessarily acts through people, and it would be for your Honor to decide completely what the intent of that legal entity is, and I don't think Mr. Chamberlain is in a position to state what the intention of the corporation is.

Mr. Wrixon: I submit, your Honor, a corporation functions only through natural persons, and natural persons who are here and who participated in the deliberations that went into this operation are competent to testify what the intention was in respect to which the units were built.

Mr. Blackstone: The most he could testify to would be his own intention. I don't see how he can say just what the corporation intended.

The Court: I should like to have you indicate what authority you have for your position.

Mr. Wrixon: If your Honor please, I have reference to a case in the Ninth Circuit, Hedderly vs. United States, 193 Fed. That, however, is a criminal case, but the language I think is significant.

(Testimony of Ross H. Chamberlain.)

The Court at Pages 570 to 571 said this. I am quoting:

"These questions were of the same character as [70-71] the question that was admitted over objection in the case of Van Gesner vs. United States, 153 Fed. 56, 82 CCA 180. In that case this court in passing up the admissibility of such testimony said—"

If I may say, your Honor, this is a further quotation from the United States Supreme Court in the case of Williamson vs. United States, 207 US 425.

The Court: Another criminal case?

Mr. Wrixon: Yes, your Honor. At Page 450 the Court said:

"The issue being the existence of a conspiracy to suborn various persons to commit perjury in relation to declarations to be made under the Timber and Stone Act as to the purpose for which they desired to acquire land, etc., and as it is conceded that no formal contracts were executed between the alleged conspirators and the proposed entrymen, and the alleged understandings were of an ambiguous nature, and the proof of the conspiracy depended upon a variety of circumstances, going to show the motive or intent, we think it was proper to permit the interrogation of the entrymen concerning their understanding of the agreement with Van Gesner and their intention at the time when they made their preliminary declarations, as the question [72] was relevant to the question of the nature and character

(Testimony of Ross H. Chamberlain.)

of the dealings of the entrymen with the alleged conspirators, and bore on the question of the purpose or motive which influenced the making of the sworn statement required by law as a condition precedent to the acquirement of the land."

The Court: I agree with all of those criminal cases. Have you a civil case?

Mr. Wrixon: Yes. *Fanning vs. Green*, 156 Cal. 279. The Court at page 285 said—and this is a case relating to an action between the administrator of a wife's estate and the plaintiff who was suing to quiet title. The question was whether there had been an intent to make a division between the husband and wife during their lifetime, and the Court at Page 285 said:

"It is well-settled that, under our system a witness may be examined as to the intent with which he did a certain act, where that intent is a material thing in the action. A jury or trial judge is not bound, of course, to believe the witness when he says he did not have a certain intent, and may find in the circumstances, acts, and language, an entirely different intent, but the testimony of the witness is competent and relevant and not immaterial."

I would like to quote one further extract from Mr. Wigmore [73] on evidence. Wigmore 714-721, Section 581, Third Edition, 1940. The conclusion of Mr. Wigmore is that,

"Such testimony is clearly admissible when it is an issue in the proceeding as to what the intent actually was."

(Testimony of Ross H. Chamberlain.)

If I may read—

Mr. Blackstone: May I say this—

The Court: Pardon me. What the intent of the corporation was?

Mr. Wrixon: The extract does not distinguish or make reference to whether it was a corporate intent or individual intent.

The Court: Well, we will concede there is a distinction, is there not?

Mr. Wrixon: I think, your Honor, that my original statement was that the intent of the corporation can be demonstrated only through the people who participated in determining the policy of the corporation.

The Court: Intent or intention may be manifested by the circumstances.

Mr. Wrixon: That is correct.

The Court: Develop them and I will give you a record on your position. I will allow it to go in subject to motion to strike and over your objection.

Mr. Wrixon: Thank you. [74]

Q. (By Mr. Wrixon): Will you state to the Court what was intended by the plaintiff in the construction of the Southwood homes?

Mr. Blackstone: What do you mean? Are you asking for his intention or the Corporation's?

Mr. Wrixon: The Corporation's intention.

Mr. Blackstone: Then, I am, of course, objecting, your Honor.

The Witness: The Corporation had a choice. It

(Testimony of Ross H. Chamberlain.)

could sell or it could rent, and the corporation chose to rent. So far as I am concerned, that was its intention, also. The intention was obligatory on the Corporation after the act.

The Court: I didn't get the last part of your answer, Mr. Chamberlain. After the what?

The Witness: After the act of construction.

The Court: Pardon me. Would you read that last part of his answer, Mr. Reporter?

(Answer read by the Reporter.)

The Court: Proceed.

Q. (By Mr. Wrixon): Well, will you describe, Mr. Chamberlain, the operation of Pacific Homes as actually carried out in the Southwood Tract after the houses were completed?

A. The Southwood Tract was constructed in the latter part of 1943 and early part of 1944. By that time the pattern of the business operation had been pretty well established. After [75] we received permission from the War Production Board and were granted priorities, the business of developing the land in a manner so that it was suitable for the construction of dwelling houses was undertaken, and then the construction of the dwelling houses was actually started on.

The first building on any one of these tracts was also used as a tract office. It housed the tract manager, and it is where the solicitation of rentals occurred.

The tract manager was generally selected from

(Testimony of Ross H. Chamberlain.)

an individual who was already living in another tract and was interested in becoming a tract manager.

The tract manager's duties included not only signing the leases on behalf of the Company, but also included the duties of collecting overdue rent and reporting to the Company complaints, requests for service, and so forth.

Mr. Wrixon: You mentioned requests for service. Would you explain to the Court what you mean by that, please?

A. Well, inasmuch as these people were renters, everything that happened to the house we had to take care of from leaky faucets and leaks in roofs and chimneys, to door knobs, and doors that don't close and paint that is marred, and so forth.

Q. And did the Corporation perform that type of service at the request of the tenants?

A. Oh, yes. We didn't repair windows that their children threw baseballs through, but if it was something of a structural [76] defect, we took care of it.

Q. Going on to the—I will withdraw that.

What change, if any, occurred in the operation of the Southwood Tract as you have just described it after the tract was completed and rented?

A. No change.

Q. Going now to the Shoreview Tract, what was the intent of the plaintiff in the acquisition of houses in the Shoreview Tract?

Mr. Blackstone: I object to the question on the

(Testimony of Ross H. Chamberlain.)

grounds previously urged. Question as to the intent of the Corporation.

The Court: What was the question again?

(Question read by the reporter.)

Mr. Blackstone: My objection is on the ground it is asking for the intention of the corporate entity rather than the intention of an individual.

The Court: What is the purpose of the question, Counsel?

Mr. Wrixon: The purpose of the question, your Honor, is again to establish the intent and purpose in the acquisition of these houses, which is one of the issues in the case.

The Court: We are dealing with a corporation, that is the only difficulty I have. If he knows and can speak for the Corporation or its members, he may do so in relation to their intent. [77]

Mr. Wrixon: That is the purpose of my question, to establish through this witness what that corporate intention was.

The Court: Very well, you may answer.

The Witness: The intent at Shoreview was the same as I have described in connection with Southwood.

Q. (By Mr. Wrixon): Will you state it for the Court?

A. We were solicited by the War Production Board to acquire that land and build houses on it because they needed houses at Mills Field—needed houses for Mills Field employees, I should say.

(Testimony of Ross H. Chamberlain.)

So the same thing is a duplication. We started to build houses and we built them, and we rented to mostly employees of airlines—anyway, somebody at Mills Field.

Q. (By Mr. Wrixon): Did the plaintiff perform the same type of maintenance services for the Shoreview Tract houses that it did for the Southwood tract houses? A. Yes.

Q. In the case of Shoreview, do you recall whether there was a sale of some seven houses out of the Shoreview Tract during the time the houses in that tract were being built? A. Yes.

Q. Can you explain to the Court the circumstances surrounding the sale of those seven houses?

A. One of the houses was sold to one of our employees who [78] insisted on buying it. All of them were in the area that the State of California had indicated—did condemn for purposes of building an overpass and appurtenant structures.

Q. And what change, if any, occurred in the operation at the Shoreview Tract as compared with the operation at Southwood? A. None.

The Court: Take a recess.

(Short recess taken.) [79]

Mr. Wrixon: Mr. Reporter, will you be kind enough to read the last question?

(Question and answer read by the Reporter.)

Q. (By Mr. Wrixon): Mr. Chamberlain, I will show you Plaintiff's Exhibit 12, being the application to the Office of Production Management relating to Homewood, and being an application re-

(Testimony of Ross H. Chamberlain.)

lating to 175 houses, and I will ask you, did you have anything to do with the preparation of Plaintiff's Exhibit 12? A. Yes, I prepared it.

Q. And that is an application for priority assistance with respect to 175 houses to be built for sale, is that correct? A. Yes, sir.

Q. The houses, 175 houses, were actually built at the Homewood Tract, is that correct?

A. Yes, sir.

Q. Did the original intention to build those houses for sale continue, or was it changed?

Mr. Blackstone: I object to the question again on the ground it is asking this witness to testify as to the intention of a corporation. That intention must be ascertained from all the circumstances and can't be testified to directly.

The Court: This is the same objection?

Mr. Wrixon: Yes, your Honor, as I understand it.

The Court: I will allow it to go in subject to your [80] motion to strike and over your objection. You may answer.

The Witness: The intention of the management and Board of Directors of the Corporation was to construct houses for rent in Sunnyvale rather than construct houses for sale.

Q. (By Mr. Wrixon): What was actually done with the houses in the tract after they were constructed? A. They were rented.

Q. And as the plaintiff attempted to rent the houses, what was the plaintiff's experience in that regard?

(Testimony of Ross H. Chamberlain.)

A Its experience wasn't so good. We had lots of trouble renting the houses, and as a result we used the device of renting with an option to purchase.

This option to purchase was entered into in the Homewood Tract for the twofold purpose of inducing people to rent the houses, and also to encourage them to take an interest in the property that they were inhabiting with the hope that they would take better care of it.

Q. What was the plaintiff's experience in renting the houses with an option in the tenant to purchase?

A. The experience? You mean whether we were able to rent them?

Q. Yes, was the purpose to rent the houses after the giving of an option to the tenant to purchase?

A. Yes, sir.

Q. And did the plaintiff offer that type of lease uniformly [81] to all the prospective tenants?

A. Yes, they did.

Q. Well, did vacancies occur in the Homewood Tract from time to time? A. Yes, they did.

Q. And when the vacancies occurred, did plaintiff lease the premises at any time to tenants without an option to purchase?

A. I don't believe so. That is, to the best of my knowledge all of the leases were exactly the same. Now, it is possible that at the very end of the operation there might have been some straight leases. However, I don't remember any.

The Court: With an option to buy?

(Testimony of Ross H. Chamberlain.)

The Witness: No, sir, just a lease like you would have on an apartment. But whether any of those were entered into or not, I can't say. I don't remember.

Q. (By Mr. Wrixon): Now, describe what was done in the Homewood Tract with respect to the operation there insofar as the tract manager was concerned, and the other things that were done by the plaintiff in order to rent the homes.

A. The Homewood Tract was the first tract and therefore could be considered to be the prototype of all of the other tracts.

We built a house there and hurried up and finished it up and installed therein a tract manager.

This was the only small tract that had a male manager, and [82] he performed the functions that I have described before as the duties of the tract manager. He supervised the leasing and entered into the leases on behalf of the company, and took care of complaints, and collected delinquent rents, and so on.

Q. Did he also take care of any maintenance or repair requests made by the tenants?

A. Yes. And inasmuch as he was a man, minor things he took care of himself, and of course major things were referred to the company for service correction.

Q. Well, from time to time after the—I will withdraw that.

Will you state to the Court, Mr. Chamberlain, why some of the houses in these tracts, Shoreview,

(Testimony of Ross H. Chamberlain.)

Southwood and Homewood, were sold by the corporation?

Mr. Blackstone: Just a minute. I object to the form of the question, why some of them—they were all sold, your Honor. That is a pretty vague question.

Mr. Wrixon: Well, if your Honor please, I will withdraw the question and reframe it. What I had in mind, the houses were not all sold at one time.

Mr. Blackstone: That is stipulated to.

Mr. Wrixon: My purpose in asking the question was merely to have the witness explain to the Court why the houses were sold, if they were, so I will withdraw the question.

Q. (By Mr. Wrixon): Explain to the Court, Mr. Chamberlain, [83] why the houses in the three tracts, Shoreview, Southwood and Homewood, were sold?

Mr. Blackstone: Just a minute. Your Honor, I object to the form of the question.

The Court: Why they were sold? The ultimate fact is that they were sold period.

Mr. Wrixon: Yes.

Mr. Blackstone: It is apparent in the stipulation the majority of the houses were sold because apparently there was an option to buy in the tenant. The Corporation didn't have any control over that in one way or the other.

Mr. Wrixon: That is true, your Honor, as to houses that were sold to tenants who had an option to buy, that was a matter beyond the control of the

(Testimony of Ross H. Chamberlain.)

Corporation. But as to houses which were sold non-option tenants, let us call them. I think it is proper that the witness be allowed to explain to the Court why those houses were sold.

The Court: And the purpose of that offer is what?

Mr. Wrixon: The purpose is, your Honor, to show the circumstances under which the sales were made, and to show that they were not made in the manner in which the ordinary real estate subdivision selling operation sells property.

The Court: How many were sold that way, if you know?

Mr. Wrixon: The exhibits will show, your Honor. I wouldn't want to state them from memory, but they are in [84] evidence as exhibits attached to the stipulation.

The Court: In the interests of time, I will allow it to go in subject to your motion to strike.

Mr. Wrixon: Would you mind reading that question, Mr. Reporter?

(Question read by the Reporter.)

The Court: Reframe your question.

Q. (By Mr. Wrixon): Mr. Chamberlain, confining your answer to the houses which were sold in the Shoreview, Southwood and Homewood Tracts to persons who did not have an option to purchase, will you explain to the Court why those sales were made by the Corporation?

A. Well, in the Shoreview Tract there were

(Testimony of Ross H. Chamberlain.)

seven houses sold at the inception, one of which was sold to one of our most valued employees at his request.

The others were sold because the State Highway Department had decided to put an overpass that exists there now at that place. And the rest of the houses in Shoreview were sold, oh, two or three years later over a period of time as people came in and wanted to buy them.

In Homewood, I don't remember any sales being made right away. And the rest of the sales were made in the same way, as people that had these option contracts anticipated them or at the very last part of the operation as they became vacant and the individuals wanted to buy them instead of rent them. [85]

In the Southwood Tract it was the same thing. A lot of those houses became vacant toward—in 1945, in the spring, and the people that rented them or rented them with these options to buy, as they became vacant, why, they were sold also.

One of the main reasons for selling all of these houses was the terrible way the tenants treated them. As I mentioned before, there was a very narrow margin of gross profit. It was only—it never exceeded \$10 a house. I believe it was less than that. And some of these people would do \$100 worth of damage. There was those that would go out of the house and take everything they could unscrew. And they always moved out in the middle of the night.

Gosh, the hardware was off and anything they

(Testimony of Ross H. Chamberlain.)

could take. Even silly things like toilet seats. Who would want a toilet seat without the rest of it? But they took it because they could get it. It was awful. It was awfully expensive.

I felt the Company was morally bound to put the house in as nearly the same condition for the next person that came and rented under this purchase option system as the first one, so that meant we had to repaint them and fix them all up, and it ran into a lot of money. In the big tracts we had service departments with two or three men in them that didn't do anything but go around fixing up after these withdrawals.

The Court: Would the tax situation take care of any [86] of these matters you have just recited?

The Witness: If we had made any money, it would have.

Mr. Wrixon: They are reflected in the expense, your Honor, that are shown in the exhibits.

The Witness: I got to rambling there. I don't know whether I answered the question or not. I am sorry.

Q. (By Mr. Wrixon): Were there any other factors which influenced the sale of the houses other than the ones that you have mentioned?

A. Well, do you want the whole story on that, Mr. Wrixon?

Q. We would like to have it.

A. Along about the spring of 1945 after I was the sole remaining stockholder in Pacific Homes, it appeared that the war was about over and the im-

(Testimony of Ross H. Chamberlain.)

minent departure of all our tenants could be expected.

The telephone company, the Pacific Gas & Electric Co., and the Bank of America all made post-war surveys as to what the business situation was going to be sometime after the war, and their conclusions were so pessimistic that I began to wonder—especially when people move out of these houses and leave them in this terrible condition.

So along about May or June of 1945, it was getting pretty difficult to find new tenants. The lawns were growing up with weeds. We had to provide someone to mow the lawns and we had to water them so that they wouldn't be lost, and also to keep [87] the tract looking nice.

It got to be too expensive to, so I decided perhaps it would be better for the Corporation to dispose of these houses as they became vacant rather than continue to try to rent them all. Although we didn't keep any houses vacant. If somebody came along and wanted to rent a vacant house and didn't want to buy it, why, he was privileged to rent it, just so we would have someone in there that would pay the Bank every month instead of us—I mean, instead of the Corporation.

Q. Now, speaking with respect to the sales of houses which were made to persons other than those who held their purchase option, will you describe to the Court what was done by the Corporation in order to effect those sales?

A. Nothing much. The tract managers were in-

(Testimony of Ross H. Chamberlain.)

structed to sell the houses as they became vacant if possible and, if not, to rent them.

Q. Was any advertising campaign carried on?

A. No.

Q. Were any "For Sale" signs put on the property?

A. No. I might explain that if you would like to hear the explanation?

Q. Go ahead.

A. It is hard to remember back so many years. I can give a categorical denial about the advertising and signs because you never do that. It gives the tract a bad name. If you have [88] a lot of "For Sale" signs sticking up, why, it goes along with the philosophy of scarcity. When things are hard to get people want them more than they do when they are easy to get.

Q. Did the plaintiff put these houses in the hands—these houses which were sold to persons other than holders of purchase options, did you put any of those houses in the hands of real estate dealers for sale?

A. Well, as these people that held purchase option contracts took up their options, and as these tracts started to get—the part we operated became smaller and smaller, we finally dispensed with tract managers, and we wound up by having one fellow that looked after all the tracts of all the corporations.

At that time, why, he couldn't handle them all by himself, and there were no tract managers left

(Testimony of Ross H. Chamberlain.)

in some cases, so real estate agents that brought in customers that wanted to buy one of these houses were permitted to sell them and they were paid commissions. But there were very few of them. We did ourselves in almost every case.

Q. Well, now, Mr. Chamberlain, going back to this matter of intention, will you state to the Court what that intention was with respect to having houses built in the Homewood, in the Southwood and Shoreview Tracts?

Mr. Blackstone: At what time?

Mr. Wrixon: At the time the houses were built.

Mr. Blackstone: You are asking Mr. Chamberlain his own [89] intention?

Mr. Wrixon: Yes.

Mr. Blackstone: Very well.

The Witness: My intention as an individual is expressed in the intention of the Board of Directors, which is implemented in the act that we committed, which was the act of renting.

Q. And was that intention of yours and the Board of Directors' applicable to each of the three tracts, the Homewood, the Shoreview and the Southwood Tracts? A. That is right.

Mr. Wrixon: No further questions.

Cross-Examination

By Mr. Blackstone:

Q. Mr. Chamberlain, as I understand your testimony, we have in evidence here Exhibit 12 which is the application for priorities relating to 175 houses in the Homewood Tract. That application

(Testimony of Ross H. Chamberlain.)

states in effect that the 175 houses are being built for sale, and you have testified that you prepared that application yourself, is that correct?

A. Yes, I did.

Q. Then is it your testimony that after this application was made that you changed your mind as to what the houses were—what was to be done with those houses?

A. It wasn't actually a matter of changing my mind. As you see on the application, it was made to the Office of Production [90] Management, and that folded up about the middle of January, just two weeks after that application was made.

The story is this, if you would like to hear it.

Q. Well, my main question, Mr. Chamberlain, if your answer is directed to that—that would be, what I was asking for was, was there a change in what your company had in mind was to be done to those houses after the application was made which stated the houses were being built for sale?

A. The change was made at the request of the—that application was made at the request of the OPM, and the change was made at the request of WPB, who succeeded the OPM. You will notice all signatures on the last page there are repeated in the WPB signatures in the ensuing years. They were the same people, but different management and a different name.

Q. In other words, your testimony is that the officials of OPM requested you not to sell these houses, is that it?

(Testimony of Ross H. Chamberlain.)

A. No, the officials of the OPM requested us to make that application, which was made by me personally on December 31st and was taken by hand up to their office to get a stamp on December 31st.

I don't pretend to know the reason for the urgency, except that it appears it had something to do with the change in the administration of the Agency two weeks later when it became the WPB, and at that time the WPB requested that the [91] application be changed to "rent," and it so was and the houses were all rented. Things were pretty mixed up right at that juncture insofar as part of the war effort.

Q. Do you recall the specific circumstances under which you were requested not to sell the houses, but rent them?

A. Yes, I recall it distinctly. The request was made by a man named Jim Whiteside in the WPB, who told us now that there was a war on, the Government felt that the houses should be made available to any war worker regardless of whether he wanted to buy or not, and also that priority assistance would be given on a higher level for houses that were built for rent than for sale, and on the basis of his advice and his request, which I felt was a request that came from the Federal Government, the houses were built and were rented.

Q. Was there an objection on the part of the Government agency to selling the houses, however?

A. Yes, definitely.

Q. How can you explain, Mr. Chamberlain, the

(Testimony of Ross H. Chamberlain.)

fact that a majority of these houses are leased with an option to purchase? Was there an objection on the part of the Government agencies to those options to purchase?

A. The option to purchase was a free gift. We were entitled to give people an option to purchase if they wanted it. The thing we couldn't do was force them to purchase it. And as I explained in previous testimony, that wasn't the intention, [92] either, in the beginning. The intention was just to rent them, and we found it was more difficult to just rent them than it was to rent them and throw in the promise, "You can buy it later on if you want to."

Q. I find that a little hard to follow in relation to the Pacific Homes because, as I understand it, the first tract was constructed at Homewood, correct? A. Yes.

Q. And all those were initially rented with option to purchase, isn't that right? A. Yes.

Q. Where was this? A preceding property?

A. Didn't you understand my answer?

Q. No.

A. My answer was that we tried to rent them and couldn't then we changed the approach and said, "You can rent them and we will also let you buy them in 30 months, and the part of your rent will say that is profit—in other words, that \$10 between forty and fifty, the accumulation of that will be your down payment and you may, if you elect

(Testimony of Ross H. Chamberlain.)

to do so, use that as your paid-in equity in the house."

Q. Do I understand correctly that on the Homewood Tract you first made attempt to rent those without an option to purchase? A. Yes.

Q. And you weren't able to rent a single house without an [93] option to purchase?

A. I suppose—I think that the guys down there couldn't rent any of them at all and the option to purchase contract was born at that time.

Q. Why, then, was there a difference between the Homewood Tract and Southwood and Shoreview that were built later? There you gave no option to purchase, correct?

A. Well, there is your answer. We didn't have to. The option to purchase was no advantage to us. There never would have been an option to purchase if I could have helped it.

Q. Would you explain that in a little more detail, Mr. Chamberlain?

A. Well, certainly. It is easy to explain. This option to purchase clouds the title to the house, and as long as an option to purchase is alive, why, the house doesn't exactly belong to you and doesn't exactly belong to the tenant. It belongs to the tenant if he wants it to, and you have to wait for him to make an election before you know where you stand. For instance, if we hadn't had these options to purchase we wouldn't have had to allow these people to abuse these houses so.

Q. I understand from your testimony, Mr.

(Testimony of Ross H. Chamberlain.)

Chamberlain, that it is your opinion that the Corporation's intention was simply to rent these houses? They had no intention to sell the houses? [94]

A. No, not at that time.

Q. Could you explain, then, why it is that all the tax returns that have been introduced in evidence and identified as tax returns of the Corporation show that the business of the corporation wasn't just the rental of houses to war workers, but the rental and sale of houses to war workers.

A. I think that designation is perfectly all right. I think it is a literal interpretation of the person preparing the returns as to the activities of the Corporation.

Q. You were engaged in making sales, then, as well as renting, is that what you mean?

A. Now, where there was a sale made, the company was in the position of having sold a house, and so I think that the return should say it covered not only renting, but also selling. Some of these sales were involuntary, as you know.

Q. Well, once you had given a purchase option in a lease to a tenant, then I take it the Corporation couldn't very well prevent the tenant from exercising the option to sell if he wanted to?

A. No.

Q. And that insofar as those leases are concerned, the corporation was, in effect, holding those houses for sale to the tenant if they desired to buy, is that not correct?

A. I think that is a fair statement. It is just

(Testimony of Ross H. Chamberlain.)

like a person in jail being a resident of the jail. It isn't because [95] he wants to. It is because he is in there and can't get out.

Q. You stated that after some experience it appeared renting these houses was not a profitable business, is that correct?

A. No, it didn't appear to be.

Q. I then take it that sometime in—you said the spring, was it, of 1945, you decided the houses should be sold as they became vacant, is that correct?

A. Yes. Well, it isn't exactly the case, either. We are talking about two different situations. In Pacific Homes the most vivid spot in my recollection is Southwood and seeing some weeds in the front yard, and that is where I decided to sell the houses as they became vacant.

Q. And when did you make that decision?

A. Oh, it was in June or July.

Q. Of what year?

A. Or May, 1945. I think it was right VE Day, which I believe was May 10th.

Q. Well, would you state that after that time, then, the Corporation or you had the intention that the Corporation should hold these houses for sale to customers as the houses became vacant?

A. No, they were held for rent; but the restriction I put on previously that they were not to be sold at all was lifted.

Q. Were there any instances that occurred that you can recall where persons came to you and asked

(Testimony of Ross H. Chamberlain.)
you to buy those [96] houses prior to that time and
you refused to sell them?

A. In Sunnyvale, yes.

Q. In Sunnyvale? Which tract is that?

A. Sunnyvale had Homewood and Southwood.

Q. At Homewood, however, the tenants all had
options to purchase—at least the first tenant, is that
correct?

Q. So that there was nothing you could do about
preventing sales to those tenants? A. No.

Q. In Southwood, you say there were instances
you recall when persons wanted to purchase the
house and you refused to sell it?

A. In the early part of the year.

Q. What year? A. 1945.

Q. As the one-year leases had expired?

A. Yes.

Q. Are you familiar with—Where are the resolu-
tions of the Board of Directors?

According to the minutes of the meeting of the
Board of Directors of Pacific Homes, Inc., on De-
cember 9, 1943, it is stated, and I quote:

“The Chairman then stated that the Corporation
had sold and would in the future sell some of the
homes owned by it, and that it would be advisable
for [97] the directors to ratify the execution of all
documents that had heretofore been executed by
officers of the Corporation with respect to sales
heretofore made, and to specifically authorize the
execution of documents with respect to sales to be
hereafter made.

(Testimony of Ross H. Chamberlain.)

"A discussion was had, and on motion duly made, seconded, and unanimously carried, the following resolution was adopted."

I won't quote the resolution, but I just want to ask you if you recall the meeting of the Board of Directors? A. Yes.

Q. In December, 1943?

A. And I can inform you as to the discussion had if you would like to hear it.

Q. I am simply interested in finding out if at that time the Corporation did not, in effect, decide that it should sell these houses?

A. Some of those houses. Some of those houses were so beat up they weren't worth keeping, and we decided to sell the ones that had been abused the worst, put them into shape and sell them to people who would take them that way.

Q. Is it not true, Mr. Chamberlain, that the decision to sell these houses was made as a result of your determination that that would be the way to make the most profit out of these [98] houses?

A. Well, insofar as we weren't making any money out of rent of them at all, I would say that was a fair statement. Whether that was my conclusion or not at any given time, I can't say.

Q. After the decision was reached to sell these houses to persons as the houses became vacant, you have indicated that the Corporation did then sell to anyone that appeared that wanted to buy, is that correct? A. Correct.

Q. And you also testified it wasn't necessary to

(Testimony of Ross H. Chamberlain.)
employ any special selling whatever because your regular staff was able to make all the arrangements necessary for the sale of the houses, is that correct?

A. Well, it wasn't a staff exactly: It was this woman who was the tract manager that did it, or the man that was the tract manager as the case may be.

Q. If I understood you correctly, then, at the time that the decision was made that the houses should be sold as they became vacant, it thereafter was unnecessary to engage in any kind of activity, any kind of active sales campaign, because the houses more or less sold themselves? Would that be a fair statement?

A. I am trying to think of the implication of that. I think that is a fair statement. [99]

* * *

JAMES E. MOORE

a witness recalled on behalf of the plaintiff, having been previously duly sworn to tell the truth, the whole truth and nothing but the truth, testified as follows:

Further Direct Examination

By Mr. Wrixon:

Q. Mr. Moore, I will show you Plaintiff's Exhibit 10, being the folder relating to the Homewood Tract, and I will ask you to state to the Court whether you examined all the folders for the Homewood Tract houses? A. Yes.

(Testimony of James E. Moore.)

Q. And did you in all the folders which you examined find one or more leases corresponding in form to the leases which are shown in the folder introduced in evidence in this case for the Homewood Tract? [101]

A. Yes.

Q. And did you examine folders in the Southwood Tract for each house in the Southwood Tract?

A. Yes.

Q. And did you find in each of the folders with respect to the Southwood Tract a lease corresponding in form to the lease which is in the folder which is in evidence for the Southwood Tract in this case?

A. Yes.

Q. Did you examine a folder for houses in the Shoreview Tract?

A. Yes.

Q. And did you find in each folder of the Shoreview Tract a lease corresponding in form to the lease which is in evidence for the Shoreview Tract in this case?

A. Yes. It could be there are some exceptions to these three tracts, and I would like to see an exhibit that I prepared so that I could point out those exceptions.

Mr. Blackstone: Are the exceptions these things which are shown in Column 4?

A. I believe so. I would like to take a look and make sure of that.

Well, yes, it is in Column 4 on the Homewood Tract at Footnote "C" where there was no evidence of a signed lease agreement in that file folder. [102]

(Testimony of James E. Moore.)

On the Southwood Tract the exception would be Footnote "A" where the manager of the tract had been allowed to transfer his option from the Homewood Tract.

And on the Shoreview Tract in the Column headed up "Other" with parenthesis A, there were seven where I found no written lease agreement.

* * *

May the record show that at a special meeting of the Directors of Pacific Homes, Inc., held on the 18th day of April, 1942, pursuant to a written waiver of notice signed by all of the directors of the Corporation, the following resolution was adopted:

"Resolved: That Robert Wood and Louis Scheungnab be, and they hereby are elected to be Vice-Presidents of Pacific Homes, Inc.; and that David Bohannon be and hereby is instructed to notify and advise Wood and Scheungnab as to their duties in relation to the negotiations of rental contracts." [103]

With the Court's permission, also, I would like to make a further reference to a special meeting of the Board of Directors of Pacific Homes, Inc.

May the record show that a special meeting of the Directors of Pacific Homes, Inc., was held at the office of the Corporation on the 28th day of September, 1946, at 10 o'clock a.m. of that day, and at the said meeting the Board of Directors proceeded to consider the matter of winding up and dissolving the Corporation, and upon motion unanimously

carried, the resolution relating to dissolution and winding up of the Corporation was then adopted.

Further, with the Court's permission, I would like to read into the record the details concerning the option to purchase which was granted to the tenants in the Homewood Tract. Your Honor has been advised that options were granted, but if I may, I would like to read the form of the option into the record.

The Court: What is your thought? What is the purpose of this testimony? To prove what?

Mr. Wrixon: The purpose of it is merely to acquaint your Honor with the terms of the option agreement.

The Court: What benefit does that enter into a tax in this case?

Mr. Wrixon: The only purpose, your Honor, is to amplify the testimony that was given yesterday concerning the [104] necessity for giving these purchase options in order to fill the houses that were held for rental, and I was merely suggesting it might be in order to inform your Honor of the terms of the option.

The Court: I am trying to follow your testimony, but in what manner does that have to do with the tax in this case?

Mr. Wrixon: Well, so far as the plaintiff is concerned, it doesn't have anything directly to do with the imposition of tax. It is just one of the statements, one of the facts which are required to be presented in order to present the entire case.

We do not believe that, in and of itself, it has any direct bearing on the tax consequences.

The Court: Very well, proceed.

Mr. Blackstone: May I reply to that comment? The Government's position is that the giving of an option for purchase has a very definite bearing on the issue of whether this Corporation was holding these houses for sale. We have no objection, of course, to the plaintiff acquainting your Honor with the details of the option. There is no objection to his reading the option.

Mr. Wrixon: May the record show that I am reading from one of the documents contained in Plaintiff's Exhibit 10, being a lease dated June 15, 1943, to L. W. Ocken. I am reading the portion relating to the option: [105]

"During the continuance of this agreement, and while you are not in default, you shall have the option to purchase the property for the sum of \$4,000 as follows:

"A payment of \$400 plus interest thereon at the rate of 6 per cent per annum from the date of this letter until paid shall be made by you in cash to Pacific Homes, Inc., at the time you elect to purchase the property; and you shall then assume or renew the then unpaid balance of the FHA loan against the property in such manner as to relieve Pacific Homes, Inc., of any liability therefor.

"You shall also pay the cost of the title policy and the cost of executing and recording documents.

"Such cash payment to Pacific Homes, Inc., will be reduced at the time you elect to purchase the

property by the difference between, one, the total of all rent paid by you and, two, the total of all FHA payments made by Pacific Homes, Inc., on the loan covering the property from date hereof.

“The additional provisions set forth on the reverse side hereof are incorporated in and made a part of this agreement. [106]

“Additional provisions:

“1. The property covered by this agreement is described as follows:

“2. If the dwelling on the property is under construction at the time this agreement is executed, the rental shall commence on the date Pacific Homes, Inc., can deliver possession of the property.

“3. No alterations of any kind in the dwelling shall be made without the prior written consent of Pacific Homes, Inc.

“4. The rentors shall pay for all utilities services furnished to the property.

“5. The renter shall keep the property in first class condition and shall pay for all repairs.

“6. The renter shall not have the right to sublet the property or to assign this agreement or any interest in the property without the prior written consent of Pacific Homes, Inc.

“7. The FHA payments referred to herein shall include all payments made on account of principal and interest, fire insurance, taxes, FHA mortgage insurance, and all other FHA charges.

“8. The option to purchase granted to the renter shall be conditioned upon the renter being acceptable to the FHA as borrowers in lieu of [107]

Pacific Homes, Inc., and shall be subject to any conditions imposed by the War Production Board.

"9. The option to purchase shall expire on the first to occur of the following:

"A. Surrender of possession by the renter, or

"B. The expiration of 30 months from the date, or

"C. Default by the renter which remains unremedied for 10 days after notice given to the renters by mail addressed to No. (blank) Avenue, Sunnyvale, California.

"Pacific Homes shall have the right to inspect the homes at any time.

"11. The renters are required to give at least 15 days' notice before vacating, and are required to remove all rubbish from the premises."

I would like to ask permission, your Honor, to read one further portion of the exhibit attached to the stipulation—Exhibit No. 1.

Your Honor will recall that the application for priorities in the Homewood case for the first 175 houses indicated it was an application for priorities to build houses for sale. It has been stipulated that after the application had been filed, that is, shortly before March 8, 1943, Pacific Homes, [108] Inc., addressed a letter to the Federal Housing Administration relating to said December 31st, 1941, application concerning the 175 houses. This is the letter, which I will now read.

The letter is undated, but it is stipulated it was written shortly prior to March 8, 1943.

“Mr. D. C. McGinnes, District Director,
“Federal Housing Administration,
“315 Montgomery Street,
“San Francisco, California.

“Re: Priorities in Case No. 77-121-000866 in
Serial No. 1731.

“Dear Mr. McGinnes:

“Number of units 175. Number of rooms, 5 (2 bedrooms). Total payment per month during option \$45.00. Agreed sales price 24 at \$4,100, 151 at \$4,000. Length of option, 30 months.

“The above application was filed under date of December 31, 1941.

“All of the above houses are completed and occupied on the rental-option plan. Although the original application was for the purpose of sale, we have proceeded on the rental-option basis and have given all occupants option to purchase. We now discover in our original application a sales price was set \$3,675. This obviously was an error as we did not vary from our original estimates [109] of cost and sales price. The price set forth in the option given to tenants is \$4,100 for 24 of the units and \$4,000 for the balance of 151 units. The FHA commitment on the 24 units is \$3,700 and on 151 units, \$3,600. The total monthly payment on all of the units is \$4,500 per month each.

“We will appreciate the approval of the sales price as originally intended as above set forth.

"Very truly yours, Pacific Homes, Inc.,

"D. D. BOHANNON,

"President."

Mr. Wrixon: That is all, your Honor, on behalf of the plaintiff.

Mr. Blackstone: May it please the Court, the Government has already introduced in evidence three of the tax returns, and we would like to introduce in evidence as Defendant's Exhibit D a copy of the minutes of a meeting of the Board of Directors of Pacific Homes on December 9, 1943. That was read to Mr. Chamberlain yesterday, but I would like to have the minutes introduced as an exhibit.

Mr. Wrixon has agreed to make a copy available so we wouldn't have to introduce the entire volume, and if that would be agreeable we would supply the Clerk either today or tomorrow with a copy to be marked Exhibit D.

DEFENDANT'S EXHIBIT D

Extract From Minutes of Special Meeting of the
Directors of Pacific Homes, Inc., Held on De-
cember 9, 1943

The Chairman then stated that the corporation had sold and would in the future sell some of the homes owned by it, and that it would be advisable for the directors to ratify the execution of all documents that had heretofore been executed by the officers of this corporation with respect to sales here-

tofore made and to specifically authorize the execution of documents with respect to sales to be hereafter made. A discussion was had and, on motion duly made, seconded and unanimously carried, the following resolution was adopted:

Resolved, that the President or any Vice President of this corporation, together with the Secretary or any Assistant Secretary of this corporation, be and they hereby are authorized to execute in the name, for and on behalf and under the corporate seal of this corporation, all deeds, agreements intended to effect the release of this corporation from liability on FHA loans, and other documents, which may be necessary or desirable in connection with such sales as may hereafter be made of real property owned by this corporation.

Resolved, Further, that all deeds, agreements and other documents of the character referred to in the first paragraph of this resolution which have heretofore been executed in the name, and for and on behalf of this corporation, by its President or any Vice President, and its Secretary or any Assistant Secretary, be and the same are and each of them is hereby ratified and approved.

[Endorsed]: Filed December 14, 1954.

We have no other evidence, your Honor.

[Endorsed]: Filed April 15, 1955. [110]

PLAINTIFF'S EXHIBIT No. 12

[Plaintiff's Exhibit No. 12 is an application by plaintiff to the Office of Production Management, Division of Priorities, dated December 31, 1941, and numbered 77-121-000866, for a preference rating on material entering into the construction of new privately owned defense housing under preference Order P55, and is applicable to 175 of the 212 houses constructed by plaintiff at Homewood Tract. The application contains a certificate by plaintiff that it proposes new construction as follows:

"4. New construction for sale (include only single-family properties for sale-detached, semi-detached, and row houses):

"(a) The number of dwelling units for sale and the proposed sales price, including land, buildings and improvements are:

"Number of dwelling units: 175.

"Sales price Per unit: at \$3,675.00.

"Number of Dwelling units: —

"Sales price per unit: —"]

[Endorsed]: Filed December 13, 1954.

PLAINTIFF'S EXHIBIT No. 13

[Plaintiff's Exhibit No. 13 is an application by plaintiff to the Office of Production Management, Division of Priorities, dated April 6, 1942, and numbered 77-121-001571, for a preference rating on material entering into the construction of new privately owned defense housing under Preference Order P55 and is applicable to 31 of the 212 houses constructed by plaintiff at Homewood Tract. The application contains a certificate by plaintiff that it proposes new construction as follows:

“5. New construction for rent (includes single-family properties for rent, and row houses):

“(a) The number of dwelling units for sale and the proposed sales price, including land, buildings and improvements, are:

“Number of dwelling units: 31.

“Total monthly rent per unit: \$50.00.

“Number of dwelling units: —

“Sales price per unit: —”]

[Endorsed]: Filed December 13, 1954.

PLAINTIFF'S EXHIBITS Nos. 14, 15, 16

[Plaintiff's Exhibits Nos. 14, 15, and 16 are applications by plaintiff to the Office of Production Management, Division of Priorities, dated May 28, 1943; September 9, 1943, and October 21, 1943, respectively, and numbered 111-00487, 99-121-00609 and 99-121-01049, respectively, for a preference rating on material entering into the construction of new privately owned defense housing under Preference Order P55, and is applicable to the total of 63 houses constructed by plaintiff at Shoreview Tract. Each application contains a certificate by plaintiff that it proposes new construction as follows:

"The Undersigned Hereby Certifies and Agrees That for the Duration of the Emergency Declared to Exist by the President on September 8, 1939:

"1. I will hold for rent the following accommodations at rental per units or in excess of the monthly charges designated in this schedule, except as otherwise authorized by General Orders 60-2 and 60-3 of the National Housing Agency; and I will not include in the lease of said accommodations any option to purchase except in accordance with said gen-

eral orders. (List on any one line only accommodations having the same room count, basic type symbol and rental. Give the exact rent in each case, not a range of rents. For information necessary to complete this schedule, see instructions):"

The number of houses to be built under the three applications are:

Family Dwelling Units

No. of Units	No. of Basic Rooms Each	Type Symbol	Lot No.	Block No.	Monthly Rent Per Accommodation		
					Total Rent	Charge for Tenant Services	Shelter Rent
51	5½	L	.....	.....	\$50.00	.....	.....
9	5½	L	.....	.....	\$50.00	.....	.....
3	5½	L	.....	.....	\$50.00	.....	.....

[Endorsed]: Filed December 13, 1954.

PLAINTIFF'S EXHIBIT No. 17

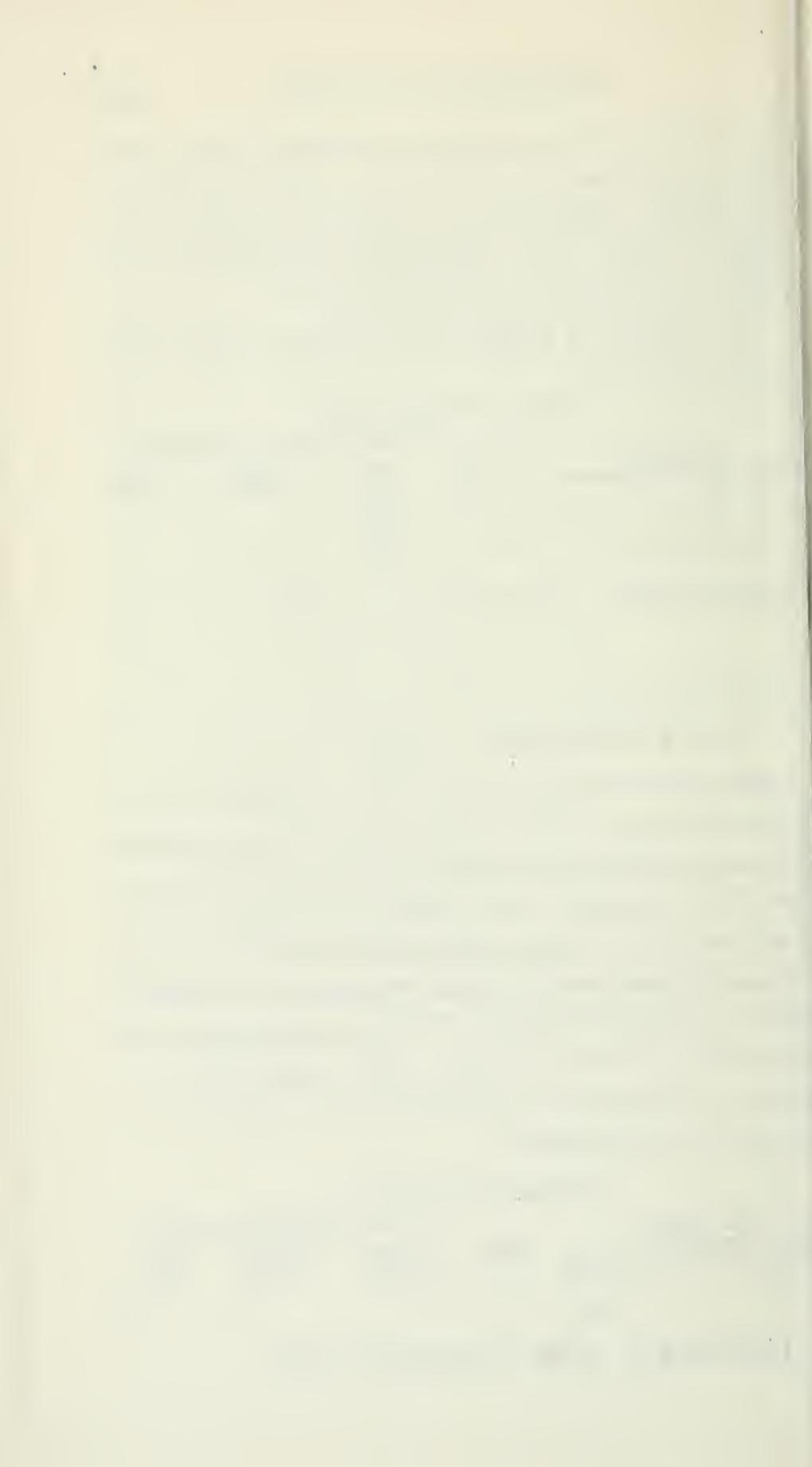
[Plaintiff's Exhibit No. 17 is an application by plaintiff to the Office of Production Management, Division of Priorities dated September 9, 1943, numbered 99-121-00563 for a preference rating on material entering into the construction of new privately owned defense housing under Preference Order P55, and is applicable to the 72 houses constructed by plaintiff at Southwood Tract. The application contains a certificate by plaintiff that it proposes new construction as follows:

Family Dwelling Units

No. of Units	No. of Basic Rooms Each	Type Symbol	Lot No.	Block No.	Monthly Rent Per Accommodation		
					Total Rent	Charge for Tenant Services	Shelter Rent
72	L	1 to 72, inc.	.....	\$50.00	.....	.....

]

[Endorsed]: Filed December 13, 1954.



PLAINTIFF'S EXHIBIT NO. 19
Filed December 13, 1954.

Form 1120
Treasury Department
Internal Revenue Service

JULY COMPLETED RETURN
UNITED STATES

Page 1

1945

For Calendar Year 1945

For fiscal year beginning June 1, 1945, and ending May 31, 1946

PRINT PLAINLY CORPORATION'S NAME AND ADDRESS

PACIFIC HOMES, INC.

(Name)

SPRING & CHESTNUT STS., F. O. BOX 1272
(Street and number)

BELMONT CITY
(City or town, postal zone number)
California
(State)

Kind of business: Development of Subdivision, Renting &
Selling Homes

Business group serial number 182
(from Instruction N)

District _____

(Cashier's stamp)

Cash Check M. O.

First Payment

\$ _____

\$ _____

\$ _____

\$ _____

\$ _____

\$ _____

\$ _____

\$ _____

\$ _____

\$ _____

\$ _____

\$ _____

\$ _____

\$ _____

\$ _____

\$ _____

\$ _____

\$ _____

\$ _____

\$ _____

\$ _____

\$ _____

Instruction No.

1. Gross sales (where inventories are an income-determining factor) \$ _____ ;
Less: Returns and allowances \$ _____ ;
2. Less: Cost of goods sold. (From Schedule A) \$ _____ ;
3. Gross profit from sales \$ _____ ;
4. Gross receipts (where inventories are not an income-determining factor) \$ 77,476.51
Less: Cost of operations. (From Schedule B) \$ 62,133.02
5. Gross profit where inventories are not an income-determining factor \$ 15,343.50
6. Interest on loans note *markman honda bank denisita et al.* \$ 1,546.00



162



Filed December 13, 1954.

UNITED STATES
CORPORATION INCOME TAX RETURN

Form 1120
Treasury Department
Internal Revenue Service

1946

For Calendar Year 1946

Fiscal year beginning June 1, 1946, and ending May 31, 1947

PRINT PLAINLY CORPORATION'S NAME AND ADDRESS

PACIFIC HOMES INC.

(Name)

650 MIDDLE AVE.
(Street and number)

MENLO PARK,
(City or town, postal zone number)

CALIFORNIA
(State)

3/1/48
E
Kind of business:

Development of subdivision

District _____
(Carrier's stamp)

Cash Check M. O.

First Payment

Renting and selling homes
Business group serial number 182
(from instruction N) Number of places One
of business

NORMAL-TAX NET INCOME COMPUTATION

GROSS INCOME

Item and
Instruction No.

Less: Returns and
allowances \$

\$

3. Gross profit from sales

4. Gross receipts (where inventories are not an income-determining factor). \$ 121,198
an income-determining factor) \$ 116,389 29

5. Less: Cost of operations. (From Schedule B) 39

6. Gross profit where inventories are not an income-determining factor

7. Interest on loans notes mortgages bonds bank deposits etc

4,808 90
2,300 .71

912
16312

Form 1121
Treasury Department
Internal Revenue Service

PLAINTIFF'S EXHIBIT NO. 21
Filed December 13, 1954.

UNITED STATES
CORPORATION EXCESS PROFITS TAX RETURN
For Calendar Year 1945

PRINT PLAINLY CORPORATION'S NAME AND ADDRESS
PACIFIC HOMES, INC.
(Name)

SPRING & CHESTNUT STS. - (P.O. BOX 1070)
(Street and number)
REDWOOD CITY, CALIFORNIA
(City or town, postal zone number)
Business group serial number entered on page 1, Form 1120 182

EXCESS PROFITS TAX COMPUTATION

ITEM AND INSTRUCTION NO.	NON-AUDIT ADJUSTMENT Character Reduction Refund or Increase or Adjustment	COLUMN 1 INCOME CREDIT METHOD	COLUMN 2 IMPOSED CAPITAL CREDIT METHOD	
			\$ (28,069 | 91)	\$ (10,000 | 00)
1. Specific exemption.....	1000			
2. Excess profits credit.....	4500			
3. Excess profits credit - AAA on income (line 46, Schedule B).....	4500			
4. Excess profits credit - based on invested capital (line 49, Schedule C).....	3000			
5. Unused excess profits credit adjustment (Schedule D).....	1000			
6. Total of items 2 to 5.....	1000			

164

[Title of District Court and Cause.]

**CERTIFICATE OF CLERK TO RECORD
ON APPEAL**

I, C. W. Calbreath, Clerk of the United States District Court for the Northern District of California, do hereby certify that the foregoing and accompanying documents and exhibits, listed below, are the originals filed in this Court in the above-entitled case and that they constitute the record on appeal herein as designated by the attorneys for the appellant:

Complaint to recover taxes paid.

Answer.

Requests for admissions under Rule 36.

Response of defendant U. S. of America to requests for admissions.

Stipulation with plaintiff's exhibits 1 to 7 attached.

Memorandum opinion.

Findings of fact and conclusions of law.

Judgment.

Notice of appeal.

Cost bond on appeal.

Designation of record on appeal.

Reporter's transcript of one volume of trial.

Plaintiff's Exhibits Nos. 8 to 22, inclusive.

Defendant's Exhibits Nos. A to D, inclusive.

In Witness Whereof, I have hereunto set my hand and affixed the seal of said District Court, this 18th day of April, 1955.

[Seal]

C. W. CALBREATH,
Clerk.By /s/ MARY C. ROBB,
Deputy Clerk.

[Endorsed]: No. 14,732. United States Court of Appeals for the Ninth Circuit. Pacific Homes, Inc., a Corporation, Appellant, vs. United States of America, Appellee. Transcript of Record. Appeal from the United States District Court for the Northern District of California, Southern Division.

Filed April 19, 1955.

/s/ PAUL P. O'BRIEN,
Clerk of the United States Court of Appeals for the Ninth Circuit.

United States Court of Appeals
for the Ninth Circuit

No. 14,732

PACIFIC HOMES, INC., a California Corpora-
tion,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

STATEMENT OF POINTS UPON WHICH
PLAINTIFF-APPELLANT, PACIFIC
HOMES, INC., A CORPORATION, IN-
TENDS TO RELY

I.

The Court erred in finding as facts upon material issues in this case the following:

(a) that the houses in the Southwood Tract were ever held primarily for sale to customers in the ordinary course of Plaintiff-Appellant's trade or business, and

(b) that the houses in the Shoreview Tract here in issue were ever held primarily for sale to customers in the ordinary course of Plaintiff-Appellant's trade or business, and

(c) that the houses in the Homewood Tract, which were sold to persons without options to buy, were ever held primarily for sale to customers in the ordinary course of Plaintiff-Appellant's trade or business.

II.

That the Court erred in failing to find as facts upon material issues in this case the following:

(a) that the houses in the Southwood Tract were held as an investment for the purpose of renting such houses to defense workers and were so held at the time that Plaintiff-Appellant decided to liquidate said tract.

(b) that the houses in the Shoreview Tract here in issue were held as an investment for the purpose of renting such houses to defense workers and were so held at the time that Plaintiff-Appellant decided to liquidate said tract.

(c) that the houses in the Homewood Tract, which were sold to persons without option to buy, were held as an investment for the purpose of renting such houses to defense workers and were so held at the time that the Plaintiff-Appellant decided to liquidate said tract.

III.

That the Court erred in failing to find as facts upon material issues in the case the following:

(a) That in early May, 1945, Plaintiff-Appellant decided to liquidate the Southwood Tract.

(b) that in early May, 1945, Plaintiff-Appellant decided to liquidate the Shoreview Tract here in issue.

(c) that in early May, 1945, Plaintiff-Appellant decided to liquidate the houses in the Homewood Tract not subject to an option to purchase on the part of the lessee.

IV.

That the Court erred in failing to find as facts upon material issues in the case, namely:

(a) that prior to early May, 1945, Plaintiff-Appellant did not sell houses in the Southwood Tract with frequency or continuity.

(b) that prior to early May, 1945, Plaintiff-Appellant did not sell houses in the Shoreview Tract here in issue with frequency or continuity.

(c) that prior to early May, 1945, Plaintiff-Appellant did not sell houses in the Homewood Tract (other than those sold to option holders) with frequency or continuity.

V.

That the Court erred in failing to find as facts upon material issues in this case:

(a) That after Plaintiff-Appellant decided to liquidate the Southwood Tract, the method in which Plaintiff-Appellant sold houses in the Southwood Tract did not amount to going into the business of selling to customers in the regular course of trade or business and that in making such sales, Plaintiff-Appellant did not thereby enter the real estate business or carry on the sales in the manner in which such a business is ordinarily conducted.

(b) That after Plaintiff-Appellant decided to liquidate the Shoreview Tract here in issue, the method in which Plaintiff-Appellant sold houses in the Shoreview Tract did not amount to going into the business of selling to customers in the regular course of trade or business and that in making such

sales, Plaintiff-Appellant did not thereby enter the real estate business or carry on the sales in the manner in which such a business is ordinarily conducted.

(c) That after Plaintiff-Appellant decided to liquidate the Homewood Tract, the method in which Plaintiff-Appellant sold houses in the Homewood Tract (other than to option holders) did not amount to going into the business of selling to customers in the regular course of trade or business and that in making such sales, Plaintiff-Appellant did not thereby enter the real estate business or carry on the sales in the manner in which such a business is ordinarily conducted.

VI.

That the Court erred in failing to find as facts upon material issues in the case the following:

(a) That Plaintiff-Appellant's sales of houses in the Southwood Tract were sales in the course of liquidation of its investment in that Tract.

(b) That Plaintiff-Appellant's sales of houses in the Shoreview Tract here in issue were sales in the course of liquidation of its investment in that Tract.

(c) That Plaintiff-Appellant's sales of houses in the Homewood Tract (other than to option holders) were sales in the course of liquidation of its investment in that Tract.

VII.

Finding number 6 of the Court's Findings of Fact is in error in stating that the Chairman of the Board of Directors of Plaintiff-Appellant expressed the intention of plaintiff to sell its houses on December 9, 1943, whereas, in fact the Chairman merely stated

that the corporation had sold and would in the future sell some of the homes owned by it. Said finding is further erroneous in failing to state (except with respect to homes in the Homewood Tract on which there was an option to sell) that plaintiff intended to rent all of its houses until it decided in early May, 1945, to liquidate the Tracts.

VIII.

That the Court erred in concluding as a matter of law that the income received by plaintiff from the sale of its houses in the Southwood Tract in the fiscal years 1945, 1946 and 1947 was taxable as ordinary income.

IX.

That the Court erred in concluding as a matter of law that the income received by plaintiff from the sale of its houses in the Shoreview Tract here in issue in the fiscal years 1945, 1946, and 1947 was taxable as ordinary income.

X.

That the Court erred in concluding as a matter of law that the income received by plaintiff from the sale of its houses in the Homewood Tract (other than sales to option holders) in the fiscal years 1945, 1946, and 1947 was taxable as ordinary income.

XI.

That the Court erred in failing to conclude as a matter of law that the gain realized from the sale of houses in the Southwood Tract held by Plaintiff-Appellant for more than six months, should be taxed as a long-term capital gain instead of as

ordinary gain, and in failing to determine the amount to which Plaintiff-Appellant is entitled by way of judgment under paragraph 15 of the stipulation in evidence.

XII.

That the Court erred in failing to conclude as a matter of law that the gain realized from the sale of houses in the Shoreview Tract held by Plaintiff-Appellant for more than six months, should be taxed as a long-term capital gain instead of as ordinary gain, and in failing to determine the amount to which Plaintiff-Appellant is entitled by way of judgment under paragraph 15 of the stipulation in evidence.

XIII.

That the Court erred in failing to conclude as a matter of law that the gain realized from the sale of houses in the Homewood Tract (except on sales to option holders) held by plaintiff-appellant for more than six months, should be taxed as a long-term capital gain instead of as ordinary gain, and in failing to determine the amount to which Plaintiff-Appellant is entitled by way of judgment under paragraph 15 of the stipulation in evidence.

XIV.

That the Court erred in failing to find as a fact that plaintiff-appellant's decision to liquidate the

tracts was caused by the adverse economic conditions incident to the end of World War II.

Dated, this 26th day of April, 1955.

/s/ L. W. WRIXON,

/s/ CARL. R. SCHULZ,

Attorneys for Appellant.

Receipt of Copy acknowledged.

[Endorsed]: Filed April 26, 1955.

[Title of Court of Appeals and Cause.]

STIPULATION THAT PORTIONS OF
EXHIBITS NEED NOT BE PRINTED

It is hereby stipulated by and between counsel for the respective parties in the above appeal that those portions of the exhibits not designated by either party to be included in the printed record on appeal may be printed by either party as an appendix to its brief, or in the alternative either party may furnish to the Court four typewritten copies of such portions.

Dated: April 28, 1955.

LLOYD H. BURKE,
United States Attorney;

By /s/ GEORGE A. BLACKSTONE,
Assistant United States Attorney, Attorneys for
Appellee.

Dated: May 2, 1955.

/s/ L. W. WRIXON,
/s/ CARL R. SCHULZ,
Attorneys for Appellant.

[Endorsed]: Filed May 4, 1955.